

KATE BISHOP: SSEES, UNIVERSITY COLLEGE LONDON, 2003.

**THE INTERNATIONALISATION PROCESS OF MANUFACTURING
FIRMS IN THE FORMER SOVIET UNION**

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ABSTRACT OF THESIS

By using a longitudinal dataset of over 200 privatised industrial companies, covering the period 1995-1998, data analysis was carried out to explore two main issues: which factors determine export activity; and which firm characteristics determine the presence of a foreign partner in a host firm?

The determinants of export intensity and propensity were examined by a wide variety of techniques. The key results are interesting for policy makers and export promotion agencies alike. It was found that large firms undergoing industrial decline are more likely to be exporters and have higher export intensities, reflecting a “push effect” into foreign markets, as a result of the decline in domestic sales. In addition to general firm characteristics, a number of hypotheses were tested concerning the relationship between ownership, board structure and exporting activity. Results showed that foreign ownership, institutional ownership, outsider control and presence of a group of dominant owners positively influence export activity. As for board structure, it was found that this has a weak effect on export activity.

This provides four conclusions: foreign owners are foreign market sourcing i.e. seeking new markets to act as an export platform (Caves, 1996); institutional investors are active or “pressure resistant” investors and act in a manner to further firm performance, as hypothesised by Kochar and Parthiban.(1996), this also confirms the efficient monitoring hypothesis of Pound (1988); a group of dominant owners may solve agency problems within an environment with a weak legal environment, as suggested by La Porta et al. (1999), and attempt to boost firm performance via exporting activity; finally outsiders need control in terms of both voting shares and seats on boards to influence export activity.

Secondly, the extent of actual partner presence was explored by using non parametric tests. Following this, logistic regression was employed to estimate the likelihood of a firm having a foreign partner or not. This analysis assumes a novel approach by treating the perceptions of the host and entering firm as a determinant of firm foreign partner presence, and includes firm characteristics such as ownership structure, firm size and investment.

The principal findings show that the likelihood of having a foreign partner increases in firms requiring investment, which export and are not large, but decreases when managers are focused upon domestic strategies and foreign partners are seeking alliances in order to gain access to local technology.

Lastly, it was found that financial performance and indicators of industrial restructuring determine whether a firm *retains* a foreign partner.

The general contribution of my thesis to extant research is to explore two of the main elements of the internationalisation process in a unique institutional environment. Results have shown that most relevant theories in the Western literature apply to the transition environment, for example, foreign ownership positively affects exporting. Furthermore, existing internationalisation research has not explored the link between organisational culture, ownership and strategic goals. Lastly, when examining the determinants of foreign partner presence the view of the *local* partner is included, whilst previous research has concentrated upon the developing country’s partner.

ACKNOWLEDGEMENTS

Many thanks to Dr Tomasz Mickiewicz and Professor Igor Filatotchev for their guidance, support, kindness and patience.

Much love and gratitude to my Mum, Connie Archer, and grandparents Alfred and Isabella Banks for inspiration. Also many thanks to Ken Archer and Henry Partridge for encouragement.

I would also like to thank SSEES for providing a friendly and stimulating environment as well as the Friends of UCL and the Ukrainian Studies Fund for financial assistance.

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CHAPTER ONE: INSTITUTIONAL BACKGROUND- THE TRANSITION PROCESS IN THE FORMER SOVIET UNION

1.1 INTRODUCTION

The principal aim of this dissertation is to investigate the determinants of internationalisation in privatised firms in three countries of the former Soviet Union (fSU), Russia, Ukraine and Belarus.

This chapter will seek to provide an account of economic developments in these three countries during the 1990's and discuss some of the major elements of transition to a market economy¹. In addition, a rationale shall be provided for studying this topic along with a brief research outline of the dissertation.

ECONOMIC AND INSTITUTIONAL BACKGROUND: THE MACROECONOMIC ENVIRONMENT DURING THE EARLY 1990'S

“The economic system of Russia has undergone such rapid changes that it is impossible to obtain a precise and accurate account of it... Almost everything one can say about the country is true and false at the same time.”

J. M Keynes (1925)

Although written over 75 years ago this comment still rings true for a country that has endured only one constant in the last 10 years: change. The years 1991- 2 witnessed the sudden disintegration of the Former Soviet Union (FSU) which was accompanied by a drastic fall in output that was larger than that which occurred during the Great Depression.²

¹ The focus here shall be on the period up to 1997, as the dependent variables are measured before this time.

² J. Rostowski, “Comparing two Great Depressions: 1929-33 to 1989-93”, in *Lessons from the Economic Transition in CEE in the 1990's*, ed. S. Zecchini. Dordrecht, Nlds: Kluwer Academic Publishers, 1997.

During the period of 1991-3 the decline in GDP in Russia was 29.9%, greater than that experienced by Canada and the US in 1929-33.

This dissolution of the Soviet Union during 1989-1991 provided Russia with the impetus to implement radical reform³. The end of 1991 witnessed the Gaidar government planning to introduce reforms and a stabilisation programme, in essence a “big bang” was to be applied to the Russian economy. In general, the aim of the programme was to restore internal and external stability, but the effect was to create a recession which would atrophy in 1-2 years, setting the scene for structural reform.

The components of the initial reform package can be classified as price liberalisation, the securing of a balanced government budget, enforcing tight monetary policy and liberalising foreign trade.

The issue of the sequencing of these reforms and the shock therapy versus gradualism polemic has been the subject of many debates⁴. The general consensus is that there can be no optimal formula to export to other transition economies, with regards to the sequencing of reforms, yet it is recognised that structural reforms need a more gradualist approach, to allow for market institutions to be created (Lavigne, 1999).

The price liberalisation of 1992 did create a big bang: by the end of January 1992, following the first month of price reform, consumer price levels had increased by 280% (see Koen & Phillips, 1993). De Melo and Gelb (1997) termed price liberalisation an “engine of growth”, creating opportunities for previously restrained activities, and constraining those that had been previously too prolific in the economy. The IMF had estimated a 50% price jump to eliminate monetary overhang (a situation where the government injects more money in the economy than households can spend given the available supply of goods and fixed prices), yet this figure was grossly underestimated. Reasons for this underestimation lie with the fact that the extent of monetary overhang accumulating since the 1960’s had been undervalued, as well as failure to thoroughly analyse the Polish case of 1990. In Poland, by 1989 monetary overhang had been partly eliminated, thus the price jump could afford to be much less extreme.

³ See Gros and Steinherr (1995), Lavigne (1999) and Vasiliev (1999) for an overview of stabilisation and economic liberalisation.

⁴ See Sachs and Lipton (1991) and McKinnon (1991) (particularly for trade liberalisation).

Repercussions of this violent price increase were threefold. Firstly, the adverse impact on society manifested itself as a decline in real wages and continuous shortages, which led the government to delay further reform for fear of a decline in popular support. Secondly the supply response to the price increase was slow, causing persistent shortages, so that the government had to re-impose price controls on staple commodities. Lastly the government failed to increase energy prices to that of the world market level, dampening the effects of foreign trade liberalisation.

In the long run price liberalisation had a tremendous impact, but alone it was insufficient to create a fully fledged market economy. The negative consequences of price liberalisation have been blamed for delaying subsequent reform, yet it could be argued that in 1992-3 the economy still lacked the required market institutions and legal instruments to advance further on the transition path.

As for external liberalisation, imports were almost entirely liberalised by January 1992 with quantitative restrictions being removed and a single tariff of 5% being applied. Although trade barriers had been dissembled a worrying distortion remained: ministries and other organisations were still allocated hard currency for imports and still not held accountable for their inefficient usage. In addition budgetary subsidies to state trading organisations for imports were not phased out until 1993, which Sachs (1994b)⁵ estimates at a cost of 10% of GDP.

Export restrictions on energy and raw materials have posed a larger problem, representing a huge loss of potential revenue for the state, as the government feared that large industrial enterprises would revolt or face bankruptcy if they had to pay world prices for such inputs.

Table one shows the extent of the price differential for selected raw materials.

Table 1: Domestic prices as a percentage of world prices, 1993.

	12/92	5/93	9/93
Crude oil	28	21	28
Heating oil	36	23	50
Diesel	34	28	55
Petrol	40	26	58
Aluminium	45	47	65

Russian Economic Trends, 1993, Table 22.

⁵J. Sachs, Russia's struggle with stabilisation: conceptual issues and evidence, Papers for Annual bank Conference on Development Economics, Washington DC, 1994.³

Additionally, the difference between the domestic and world price provided an opportunity for workers in the energy sector and corrupt civil servants to transport vast quantities of oil and other raw materials to other republics and re-export for a huge profit.

Although a serious attempt was made to divert trade away from Socialist economies towards market based trade with the Western world, this trend had already begun in 1986. During this period the share of CMEA (Council for Mutual Economic Assistance) trade fell by a half to 20%, yet that of the market economies had doubled, thus trade reorientation had started previous to the events of 1991.

A greater deal of success was enjoyed in the sphere of convertibility. In July 1992 full current account convertibility was permitted, exchange rates were unified and foreign exchange auctions were inaugurated for those wanting to make an import order.

Unfortunately the dramatic consumer price increase in 1992 was not a once and for all ascent, only in 1994 did monthly average inflation begin to fall below 20%.

1.2. WHAT WERE THE CAUSES OF RUSSIA'S DESTABILISATION?

It appears that a large fiscal deficit was not at the root of Russia's destabilisation, as the official estimate for fiscal deficit was relatively low compared to other transition economies at 4.8% of GDP in 1992, the reason being the government's concern with inflation. The table below shows the official Russian Budget.

Table 2: The extent of the Russian fiscal deficit as a percentage of GDP

As % of GDP	1992	1993
Revenue	37.8	31.5
Expenditure	42.5	36.5
Balance	-4.7	-4.0

Ministry of the Economy, Republic of Russia

In short, it appears that a fiscal deficit was not a major contributor to macroeconomic destabilisation. However, The Ministry of the Economy's decision to implement credit expansion in order to clear mounting inter enterprise debt and a loose monetary policy eventually did lead to inflation. In addition, this expansion of monetary credit continued the soft budget constraint of state owned enterprises, acting as a buffer against eventual bankruptcy.

However, credit expansion was not limited to the state enterprise sector, and by 1993 its share of credit was starting to decline, to only 0.1 % of GDP, which eventually led to quantity constraints on credit growth.

Table 3: Net credit of Central Bank of Russia

Received by:	1992 as % of GDP	1993 as a % of GDP
Ministry of Finance	13.4	5.9
Commercial Banks	13.8	3.9
CIS	8.7	1.6
Enterprises	0.2	0.1
TOTAL	36.1	11.5

Gros and Steinherr (1995)

The result of such destabilisation created a huge inequality of income between the those in state industry, who were treated favourably by the financial sector and were able to obtain access to cheap credits, and those who were not recipients of credit from other sources. This has been at the expense of the *de novo* private sector. According to Pripisnov (see Dyker, 1999) the number of small/medium enterprises reporting a decline in gross income has been rising since 1992. One of the reasons cited for this maybe that large state owned enterprises have been choking off available credit.

By 1994 it had been understood that the Central Bank of Russia could no longer issue large credits without causing inflation and its source was basically monetary, according to Nikolic (2000). It appears that Russia's stabilisation programme, in essence, was based on shock therapy to appeal to the IMF and its' creditors, but eventually had to be adapted to placate the former *nomenklatura* and regional and industrial lobbyists. Consequently reforms could only be introduced loosely.

As for Ukraine, Filatotchev *et al.* (1999) state "Ukraine occupies an intermediate position" between the two polar cases of Russia and Belarus with regard to market reforms.

Despite Belarus adopting various market orientated programmes in 1992 macroeconomic stabilisation and the implementation of privatisation have been slow to follow⁶. Some progress has been made in the realm of price liberalisation: margin limits on wholesale and retail were eliminated by 1994, and prices on agricultural and food products were also liberalised following an agreement with the IMF by 1995. Unfortunately, the currency crisis

of March 1998, and the ensuing inflation saw the government banning any price increases above 2% in the private and public sectors, a great setback for the previous liberalisation stance.

As for external liberalisation, in May 1994 Belarus unified its export and import duty system, allowing tariffs of around 15-20%, and by 1995 export tariffs had been dismantled.

However, convertibility during the early 1990's, was somewhat erratic: despite the Belarussian rouble becoming sole legal tender in 1994, restrictions on convertibility still remain. In fact the future of the Belarussian rouble is unclear, in 2001 it was pegged to the Russian rouble, and now plans are being initiated to adopt a common currency by 2008. However, Belarus has seen a slight increase in its ranking on trade and foreign liberalisation by the EBRD from 1994-2000, it has moved from a 1 to a 2- (Estrin, 2001)m see table 7 for a definition.

Unfortunately monetary policy has been ineffectual in preventing large amounts of credit flowing to state owned enterprises and the agrarian sector, worsening inflation and dampening the growth of the already small private enterprise sector, as the figures show below.

Table 4: Inflation, Credit, Budgetary subsidies and the private sector in GDP in Belarus

	1992	1993	1994	1995
Consumer prices*	969	1188	2200	709
Budgetary subsidies**	-	-	6.3	3.4
Credit to enterprises**	-	-	16.5	5.5
Private sector share in GDP	-	-	15	15

*annual average, percentage change, **as percentage of GDP, EBRD Transition Report, 1997.

In Belarus fiscal reform has enjoyed some success, however credit to enterprises was still substantial in 1994, reaching 16.5% of GDP (EBRD, Transition Report, 1998), representing

⁶ The Transition Report 2001 documents that the "*state will continue to play a dominant role in the economy,*" (p119), while Estrin (2001) notes that Belarus still has private sector activity below 25% of GDP, and that the state has kept a share of more than 15% of privatised firms (p14).

a significant drain on the government budget. However by 2001, the social safety net is still a matter of importance for the Belarussian government and the World Bank.

Ukraine was the setting in the 1990's for various incompatible reform programmes. Ukraine only began to make progress in stabilising its economy as late as 1994.

Price controls were not lifted until October 1994, relatively late, even compared to Belarus, but further price adjustments were made in 1995, so that only socially sensitive products such as bread, utilities, transport and fuel were subjected to price control. Some differentiation was made for residential and industrial users of energy, with prices remaining below cost recovery for residential agents, and above cost for industry.

Trade liberalisation lagged behind until the end of 1994, when the export sector was freed from quotas and restrictive licensing. Despite re-introducing restrictions on the export of grain in 1995, retaining import tariffs at an elevated level of 10-20% and not introducing full current account convertibility until 1997, Ukraine's progress has been recognised, with an Interim Agreement on trade being signed with the EU. In addition, Ukraine has made progress in its negotiations for accession to the WTO.

As is the case in Russia, difficulties remain in Belarus with the reform of financial institutions. The EBRD Transition Report 1998 documents that the banking sector is largely dominated by the state owned banks⁷. The table below reports on particular aspects of the financial system. Clearly, foreign banks are not being encouraged and the problem of bad loans is troubling. In addition, the NBB's attempt in 1998 to enforce minimum capital requirements has been repeatedly postponed to avoid bank closures.

Table 5: Growing problems in the Belarussian financial sector.

	1994	1995	1996	1997
No. of banks (foreign owned)	48(na)	42(1)	38(1)	38(2)
Bad loans (as % of total)	8.4	11.8	14.2	12.7

EBRD Transition Report, 1998.

As for fiscal reform, there are still some advances to be made with tax collection and reducing credits to enterprises', in fact tax revenue as a percentage of GDP declined during 1994-7, with budgetary expenditure showing the reverse position, as shown below. Budget

⁷ The Belarussian banking sector is also highly concentrated with three state owned banks accounting for nearly 75% of total loans in the entire banking system.

constraints have not been tightened for enterprise restructuring, thus changes in the tax structure and expenditure cuts must be made to reduce the deficit to its target, set by the IMF in September 1998 (according to the EBRD).

Table 6: Falling tax revenues in Belarus, 1994-7

	1994	1995	1996	1997
Tax revenues*	41.6	34.4	32.0	34.7

*as a percentage of GDP, EBRD Transition Report, 1998

Finally, it must be noted that the political disruption and the currency crisis of March 1998 both play an adverse role in reducing and mediating the impact of reforms, and in the case of Belarus may have even be responsible for the reinforcement of state planning tendencies (Filatotchev et al, 1999). However we cannot expect the financial crisis⁸ to affect the analysis of data in this study as dependent variables are measured for 1994, 1996 and 1997.

1.2.b ECONOMIC TRANSITION IN RUSSIA, UKRAINE AND BELARUS TO DATE

Before the literature review is presented in chapter two, it would be illuminating to give an overview of the transition progress of the countries to be studied, particularly in the sphere of *structural transformation* as opposed to the macroeconomic stabilisation process described above. The aims of structural transformation are to build a market environment, build a modern financial sector, conceive a developed tax policy and develop a social security sector to cushion the effects of stabilisation. The cornerstone of structural transformation is privatisation, creating infrastructure for de novo private firms and privatising state owned enterprises. This issue shall be pursued in the transfer of ownership section in chapter two. Also of paramount importance is the reform of the banking and financial sector, to mobilise domestic savings for enterprise restructuring, and facilitate the bankruptcy procedure.

The EBRD Transition Report 1996 puts both Russia and Ukraine in the “intermediate stages of transition” category, while it notes that these countries have all made progress in price and trade liberalisation as well as cutting some enterprise subsidies, it claims that they are less advanced in structural reform., compared to the Central and Eastern European and Baltic countries.

As for Belarus the conclusion is less promising, being classified on a similar standard as China or Vietnam: *"Since 1994 it has become increasingly apparent that Belarus is not, politically or economically a post communist transition country- not any more than China or Vietnam,"* (Nutti, 1999)

Before we look at developments in banking and financial sector reform, tax policy and the social security system, the EBRD transition indicators shall be presented for a selection of transition economies.

Table 7: Progress in transition in Eastern Europe, the Baltics and the CIS Enterprises(1998)

Countries	Private sector share of GDP%	Large scale privatisation	Small scale privatisation	Governance &Enterprise restructuring
Belarus	20	1	2	1
Bulgaria	60	3	3+	2+
Czech Republic	80	4	4+	3
Hungary	80	4	4+	3+
Latvia	65	3	4	3-
Poland	65	3+	4+	3
Russian Federation	70	3+	4	2-
Tajikstan	30	2+	3	2-
Ukraine	55	2+	3+	2

Markets and Trade

Financial Institutions

Countries	Price liberalisation	Trade & For. Exchange system	Bank reform & interest rate liberalisation	Securities mkt. & non bank financial instns.
Belarus	3	4	2	2-
Bulgaria	3	3+	2+	2
Czech republic	3	4+	3+	3
Hungary	3+	4+	4	3+
Latvia	3	4+	3	2+
Poland	3+	4+	3+	3+
Russian Federation.	3-	2+	2-	2-
Tajikstan	3	3-	1	1
Ukraine	2+	3+	2	2

Adapted from EBRD, Transition Report, 1998.

⁸ See Nikolic (2002) for a good description of the financial crisis.

These indicators summarise progress of economic reforms since 1994. Classification indicators: most advanced industrial economies would achieve 4*, while 1 being the weakest score. (See p27 of the Transition Report for notes on the classification system.)

The EBRD indicators confirm that no real progress has been made in the sphere of banking and the financial sector reform. Estrin and Wright (1999) also document pessimistic findings for Belarus, having found that banking sector reforms have even deteriorated. Credit allocations still favour state enterprises and agricultural units, with the state still being heavily involved in the banking system. These directed credits have helped contribute to inflation, which rose above the 1996 target of 2% a month. However, monetary policy in Belarus is governed by an independent central bank, the NBB, which has been classed the ninth most independent bank in the whole world, according to the 1994 law⁹. Yet, this level of independence can be questioned as the President has the power to replace the NBB president, and revoke any of his decisions.

Banking reform aimed to change the socialist monobank into a two tier system of an independent central bank, with many commercial banks operating underneath this. It was hoped that their role would support the stabilisation programme, provide finance to the economy and facilitate privatisation and enterprise control. This has not transpired. It would appear that these transition economies would have been wise to adopt the UK/ US banking model, with banks performing savings and lending activities, staying uninvolved in corporate activities and having arms length relationship, which would not have allowed the continuation of Soviet era networks. On the other hand, the Japanese/German blueprint, whereby companies raise external finance from banks with which they have a close long term relations. In reality, it seems that the banks in the CIS have attempted to mix the two systems, leading to many of the private banks in Russia becoming fraudulent fronts for money laundering (Gaddy and Ickes, 1998). In Russia some of the biggest banks, particularly Sberbank (the national savings bank) and Vneshtorgbank (foreign trade bank) are entangled in financial industrial groups and enjoy political and personal relationships with

⁹ See Nuti (1999). See the work of Ilieva (2000), at Manchester Metropolitan University which details the indices used to measure central bank independence.

industrial enterprises. This makes it very hard for banks to enforce limits on emergency credit, and initiate bankruptcy proceedings, as they have no incentive to monitor the behaviour of management. This occurs as banks may be under pressure from the government to prevent the decline of certain sectors.

However banks are granted privileges for these services in the form of direct wealth transfer, opportunities to operate without transparency, which maybe detrimental to minority shareholders, through share dilution and transfer pricing. Furthermore, prevailing central bank supervision is still weak, with some banks still not meeting capital requirements and capital adequacy ratios.

In the Ukraine the banking sector is still small and undercapitalised (see table 8.) Yet since the poor liquidity position of 1998, caused by the rescheduling of government debt the NBU (Ukraine's central bank) has taken some measures to improve the situation. International accounting standards were introduced in early 1998 and the limit on foreign ownership has been abolished, in order to create more competition and capital.

In brief it appears that it would have been sensible for the three countries to adopt the UK/US style of banking system., which would have helped prevent fraudulent relationships between banks and firms.

Table 8: Scale of deposit taking and lending in selected transition economies (Ratio of broad money to GDP in %).

	1993	1994	1995	1996	1997
Belarus	-	39	15	15	18
Czech Republic	70	73	81	75	71
Hungary	50	46	43	42	42
Poland	36	37	36	38	40
Russia	24	21	17	16	17
Ukraine	32	27	13	12	14

IMF, International Financial Statistics and EBRD.

Inefficient tax policy has helped contribute towards the negative government balances, (see table below) making tax reform an urgent item on the agenda. At the root of the problem lies the failure to collect tax revenue; in turn this means that growing social problems in Russia, Ukraine and Belarus cannot be tackled. The problem appears less acute in Belarus, as

compared to Russia or Ukraine achieving tax ratios of 32% of GDP, one of the highest ratios of the CIS (EBRD, 1998), this reflects compliance to tax regulation and careful supervision. However, the system in Ukraine and Russia has required some attention.

Although the Ukrainian system of tax administration is still in need of development, efforts have been made to encourage small businesses to enter the formal sector, by simplifying tax registration regulations. Similar pains have been made in Russia to streamline the tax system following expansive tax avoidance, by introducing a new Tax Code in 1998 (EBRD, 1998).

Table 9: Tax Revenues as % of GDP and government balances in Russia, Ukraine and Belarus, 1995 and 1997.

	TAX REVENUE	GOVERNEMENT BALANCE ¹⁰
Russia		
1995	35.9	-5.7
1997	32.2	-7.4(est)
Ukraine		
1995	32.6	-7.1
1997	34.3	-5.6(est)
Belarus		
1995	34.4	-1.9
1997	34.7	-2.1(est)

EBRD Transition Report 1998.

It is highly likely that experts underestimated the necessity for a strong social security system to cushion the impact of stabilisation. Institutions must be constructed to take responsibility for the social protection that was provided, and to some extent still is, by enterprises (EBRD Transition Report, 1998). Policy towards unemployment, health care and the pension system all demand adaptation given the startling degree of poverty associated with the CIS. The EBRD Transition Report (1998) highlights this, stating that Russia and Ukraine endure a situation where “inequality is among the highest in the transition economies”. The extent of inequality of earnings is shown below, measured by the Gini coefficient¹¹.

¹⁰ In % of GDP.

Table 10: Gini Coefficient of earnings

	1989	1996
Belarus	0.26	0.41
Russia	0.23	0.48
Ukraine	0.25	0.41
Poland	0.21	0.29
Slovenia	0.22	0.30

Adapted from Transmonee database, Unicef, 1997.

The policy response in Belarus to this problem has been slow, but this is not surprising since the current situation is not as desperate, with “only” 23% of the population in poverty, yet eventually measures will have to be taken to create an efficient system for the provision of unemployment benefit when a higher degree of enterprise restructuring is achieved.

As for, Russia there is still much progress to make in creating an efficient social safety net. Most enterprises still supply most social services, such as child care and health provisions. The table below reports the state intervention index, revealing that Russia, Ukraine and Belarus are experiencing higher levels of intervention, compared to other transition economies.

Table 11: State intervention index

	State Intervention index
Belarus	42.5
Czech Republic	20.0
Poland	15.0
Russia	18.2
Ukraine	29.1

Transition Report, 1998. Business Environment and Enterprise Performance survey.

State Intervention index: calculated as the average across all dimensions of firms reporting a degree of intervention.

Without an efficient social safety net large scale restructuring will be impossible in much of the CIS, so developing public institutions to deal with these issues should be at the forefront of policy making. The reform of the social welfare system will be complementary to the hardening of budget constraints; this will remove any economic distortions that may be linked with production subsidies or protectionist policies. The social safety net will need to be more general and cash based, moving away from the system of enterprise based benefits.

¹¹ A value of 0 represents a situation where income is distributed equally among society, and a value of 1 represents a situation where one person holds the entire earnings of society (other measures can also be used: 10th percentile of earnings distribution as % of the median, Robin Hood index etc.).

However enforcing hardened budget constraints on enterprises can have wide social consequences which can be particularly problematic in enterprise towns where the whole population of a region or district may be affected.

Additionally, unemployment benefits are very low (about 10% of the median wage, EBRD, 1998 and Unicef, 1997) preventing enterprises from creating open unemployment. This is obviously an area of reform that must receive attention if the tendencies towards poverty are to be reversed.

1.3 FOREIGN ECONOMIC RELATIONS AFTER THE DISINTEGRATION OF THE FORMER SOVIET UNION

Prior to the transition period foreign economic relations had already been reformed under Gorbachev, who had recognised the failure of the Soviet Union to export manufactured goods for hard currency from 1973-84. Some lay the blame for this phenomenon on the over development of the energy and military sector at the expense of other industrial sectors, "*which in turn had contributed to the poor quality and low level of manufactured exports.*" (Smith, 1993). Imports were also a source of contention at this time, with Soviet imports mainly consisting of grain and machinery, particularly for pipeline construction. What was needed was an alteration in the structure of these imports and exports. The principal problems facing the Soviet Union can be summarised below succinctly, as suggested by Smith (1993)

- the isolation of domestic producers from foreign competition
- Soviet managers lack of knowledge of foreign markets
- an absence of FDI
- currency convertibility
- the differential between world and domestic prices.

Thus Gorbachev and Ryzhkov announced in March 1986 their trade strategy, claiming that it was necessary to stimulate the competitiveness of exports of manufactured goods and introduce an import policy that would favour industrial modernisation. Yet at this time the central state monopoly of foreign trade was still in existence which would prove to be unable to cope with a diverse structure of imports and exports.

Gorbachev's reforms to the foreign trade system

The aim of these reforms was to adjust the administrative side to the operation of the foreign trade system, by decentralising the Ministry of Foreign Trade (MOFT) into 21 industry ministries. It was anticipated that more efficient methods of economic management of the trade system would develop as a result of this. However the MOFT still kept control over trade in fuel, raw materials and foodstuffs.

Secondly, the exchange rate system needed to be revised and eventually made convertible. The arbitrary differences between Soviet relative prices and world prices meant that a single exchange rate could not be used, to address this problem DVKs or differentiated valuation coefficients were implemented to convert the prices of imports or exports of decentralised trade into roubles. The complexities of computing these coefficients, along with other problems led to the introduction of a single exchange rate in 1991.

Lastly, attempts to attract foreign investment and encourage joint ventures were taken. For example, the Soviet partner was no longer required to hold the majority share of the joint venture, and in addition the chairman of the board no longer had to be a Soviet citizen. In addition, tax breaks were offered to foreign partners in order to attract more joint venture activity.

The table below shows that these reforms were not successful in modifying the dependency of energy exports to manufactured goods, using oil and machinery exports as indicators. Some manufacturing exporting sectors did manage to increase the volume of exports, but in relatively unsophisticated areas such as textiles.

Table 12: Soviet exports to non Socialist Countries, 1984-9, (million roubles)

	1984	1985	1986	1987	1988	1989
Total	32,277	28,196	22,686	23,942	24231	26515
Machinery	2561	2622	2444	2650	2468	2449
Oil	13,567	10,623	5522	7103	6282	6686

Vneshtorg.

Following the dissolution of the former Soviet union in late 1991 and the subsequent collapse of the “bloc autarky”¹² under COMECON it was anticipated that these countries would abandon their past behaviour and re-orientate trade towards the West, abandoning some of their links with other former republics.

At this time, in Russia foreign trade was to be liberalised as “*external aspects of reform... (bring) access to know how accumulated by the market economies (which) promise huge gains in productivity,*”¹³ In order to enjoy these benefits the following actions were to be taken:

- the state monopoly on foreign trade was abolished
- the exchange rate was to be unified
- availability of unrestricted foreign exchange for current account transactions
- the elimination of quantitative restrictions on foreign trade.

However McKinnon (1991) argued that there should be some “interim protection” to sustain some long term viable industries, as the goal of exchange rate unification is to eradicate export taxes (usually on energy) and import subsidies. Consequently, the domestic currency prices of these items would rise to world levels, increasing the cost of inputs for producers.

Referring to the study of Spain, Greece and Portugal’s experience of export led growth (see Gros and Steinherr, 1995) this looked to be a promising policy option for the transition economies. However Gros and Steinherr later dubbed Russian trade policy a “disaster area” due to the persistence of huge import subsidies and export restrictions contributing to the decay of Russian foreign trade in comparison with countries of Central and Eastern Europe.

The table below highlights Russia’s backwardness in exporting to developed countries, as compared to Central and Eastern Europe. Unfortunately, Russia’s ranking by the EBRD on trade and foreign exchange liberalisation has actually fallen from 3 to 2+ over the period 1994-2000 (Estrin, 2001).

¹² Lavigne (1999).

¹³ Gros and Steinherr (1995)

Table 13: Russian Patterns of Foreign trade: shares in total trade 1990, 1993 and 1997 in transition countries.

	1990	1993	1997
Eastern Europe			
Exports to transition economies: FSU	22.3	9.2	10.3
Developed market economies	49.5	58.0	66.5
Former Soviet Union			
Exports to transition economies	25.9	26.3	26.8
Developed market economies	49.5	59.7	58.1

ECE/UN, 1994a, 1996a, 1998.

Table 14: Total exports in millions of US dollars 1987-1996 (current)

	1992	1993	1994	1995	1996
Russia	49682	52293	85342	105202	115254
Belarus	1061	758	2509	4156	-
Ukraine	3744	3222	10305	13317	14441

UN Statistical Yearbook, 1997.

In all three countries exports have increased, as table 14 shows, yet this disguises the fact that in some sectors exports have been falling, as shown below.

Table 15: Russian Exports of machinery and transport equipment and manufactures 1990-8 (billions US dollars for manufactures, million US dollars for machinery and transport) (current).

	1995	1996	1997	1998
Machinery and transport	4943	7999	8219	6243
Manufacturing	21.68	30.05	27.40	23.41

WTO Annual Report, 1999.

The Direction of trade

The EBRD Transition Report (1999) compares actual trade with the EU and predicted trade with the EU, using the gravity model of trade¹⁴. This study shows that CIS countries

¹⁴ See Brenton, P and Gros, D, (1999)

are still largely dependent on trade with other transition economies; in short they have “under-performed” and failed to develop intra-regional trade links.

Table 16: Actual and predicted direction of export trade, 1997 (% of total).

	Actual trade with EU	Predicted trade with EU	Actual trade with Transition Economies	Predicted trade with TE
Belarus	0.07	0.59	0.90	0.11
Czech Republic	0.61	0.72	0.32	0.07
Hungary	0.70	0.65	0.19	0.10
Poland	0.71	0.73	0.22	0.09
Russia	0.38	0.50	0.38	0.06
Ukraine	0.16	0.57	0.65	0.10

Adapted from IMF Direction of trade statistics and EBRD calculations.

Table 17: Percentage of exports to non transition economies, 1997.

	Percentage of exports to non Transition economies
Belarus	9.9%
Poland	77.5%
Russia	61.9%
Ukraine	34.8%

The Transition Report, EBRD, 1999.

The relatively poor export figures of Russia, Ukraine and Belarus in table 17 are surprising given the level of the exchange rate and several devaluations. Details of exchange rate paths in these three countries from 1992-97 are shown below.

Table 18: The end of year exchange rate, 1992-97: Belarussian rouble, rouble and hryvnia to the US\$.¹⁵

	1991	1992	1993	1994	1995	1996	1997
Belarus	134	51	698	10,600	11500	15500	30,740
Russia	0.134	0.511	1.247	3.55	4.640	5.974	20.650
Ukraine	na	0.01	0.13	1.04	1.79	1.89	1.90

EBRD, 1999

¹⁵ It should be noted that in 1992 Ukraine introduced an interim currency the karbovanets, in 1992 the Belarussian rouble was introduced and in 1993 the new Russian rouble was introduced.

In Russia the real exchange rate began to increase in 1996, increasing the price of Russian goods, relative to other countries' goods (shown below), which may have adversely affected the level of exports the following year.

Table 19: The Russian exchange rate (annual average), data in new denominated roubles per US dollar. One new rouble =1,000 old roubles.

	Roubles per US dollar
1994	3.55
1995	4.64
1996	5.57
1997	5.97

Transition Report, 1998.

1.4 RATIONALE FOR STUDY

Despite the problems mentioned above, it is obvious that a significant number of enterprises in some countries of the former Soviet Union are involved in export activity. The table below shows the percentage of firms exporting to the non near abroad or CIS countries in the sample used in my research. As many firms had trade links with the former CIS countries pre 1991 I decided it would be more useful to examine the determinants of exporting to “non near abroad” countries.

Table 20: The percentage of firms exporting to non near abroad countries in Russia, Ukraine and Belarus in 1995 and 1997.

	1994	1996
Belarus	34.3%	43.3%
Ukraine	19.4%	22.2%
Russia	16.8%	17%

Source: University of Nottingham database

Table 21: Export intensity in Russia, Ukraine and Belarus in 1994-1997

	1994	1996	1997
Russia	2.1	3.4	3.9
Belarus	8.8	10.8	7.4
Ukraine	3.2	6.6	6.2

Source: University of Nottingham database

Studying the export behaviour of privatised former SOE's in the mid 1990's in Russia, Ukraine and Belarus presents an ideal opportunity to investigate factors which are affecting the decision to export in this new environment. It will be illuminating to see if the issues

concerning export behaviour discussed in Western literature have the same relevance in transition economies.

Other studies have focused on the impact of the macroeconomic level to destabilisation and industrial decline (see Gomulka, 1995, Hendley *et al.* 1998, among others). Here an attempt to examine one particular response to the “Great Transition Depression” of the enterprise sector in Russia, Ukraine and Belarus is made- have firms reacted to the change in incentives and undertook export activities?

These three countries represented 86.5 % of the industrial output (UN, 1992) prior to the disintegration of the FSU in 1991, providing a natural rationale for their inclusion in this study. This investigation will make use of two large surveys carried out in 1997 and 1998, along with the 1997 study, for the case of Russia, encompassing retrospective questions, creating a longitudinal panel for analysis.

1.4b MAIN RESEARCH QUESTIONS

This study proposes to investigate a particular element of *strategic restructuring* (EBRD, 1995) namely the internationalisation process (IP) in Russia, Ukraine and Belarus. The factors that propel the decision of the firm to internationalise and seek a foreign partner will also be determined.

The extant literature documents the benefits of exporting at the macro level. For example, Otani and Villanueva (1990) remark on the contribution of export performance on the growth of per capita real income for 55 developing countries in the late 1980's. They estimate a regression equation using the growth of per capita real GNP as the dependent variable, as explained by the savings rate, export performance, expenditure on human capital development, the real interest rate on external debt and population growth. Their main findings are that export expansion has powerful positive effects on growth; an increase in the export/GNP ratio by 2% points would cause a rise in steady state per capita output growth by 4-5% a year(p778)¹⁶. However, they suggest that export promotion policies should be country specific as the coefficient on growth of exports changes for different levels of income, as shown below.

¹⁶ The coefficient on the growth of exports is 0.4 for low income countries , and 0.43 for high income countries.

Table 22: Cross country regression results: Income groups with growth of p.c real GNP as dependent variable, 1970-85.

	Growth of exports (%)
Low income countries	0.4 (3.28)
Middle income countries ¹⁷	0.1 (0.8)
High income countries	0.43 (3.37)

Otani (1990) p 776. Figures in parentheses represent t ratios.

Brezinski and Kalthoff (1998) argue that the development of foreign trade in the form of its structure and orientation, will accelerate economic restructuring.

Moreover the World Bank in 1993 declared that it considers export orientated growth to be the hallmark of a successful development strategy for Less Developed Countries, so it could also apply to middle income transition economies.

Yet, this research will look at the determinants of export activity at the micro or *firm level*, thus we have the following:

$$X_i = f(E, DF)$$

Where DF is a set of decision factors which affect a firms decision process as to whether to seek export markets or not (X_i). These may be experiential learning effects, growth strategy, firm size or ownership structure. E represent exogenous factors such as sectoral, regional and industrial decline “push” factors. Thus the impact of *external and internal factors* on the firms decision to export shall be examined, adopting some of the independent variables from the management and economics literature.

The effects of ownership structure on exporting activity will be a major part of the analysis. For example, which ownership structures favour greater degrees of internationalisation? It will be assumed that exporting will be a strategy for performance improvements (see chapter five for details).

Furthermore, the choice of *degree of internationalisation* available to the firm will be explored What is the rationale for a firm selecting a particular entry mode, in particular acquiring and retaining a foreign partner? An attempt will be made to determine which factors affect the firm’s decision to acquire a foreign partner, giving

¹⁷ It should be noted that Otani’s study does not include Socialist countries.

$$FP = f(I + AP)$$

where FP represents if a firm has a foreign partner, I is internal factors such as ownership structure, firm size and investment levels, and AP represents attitudes and perceptions towards foreign partners and market strategy. This will allow us to determine which kinds of firms are more likely to possess and retain a foreign partners.

1.5 THE OUTLINE OF THE DISSERTATION AND HYPOTHESES

The second chapter shall present a literature review of the internationalisation process and privatisation, mainly in developed economies.

Chapter three examines the methodology adopted and describes statistical methods in detail, also information on survey techniques, and the quantitative approach shall be presented.

Lastly, a comparison of other research methodologies in existing literature on exports and foreign partner selection is made. Following this, in chapter four, descriptive statistics and exploratory data analysis shall be presented.

Chapter five will explore the impact of ownership on export activity. By employing linear regression, repeated measures and weighted least squares techniques we are able to test the following hypotheses and finally conclude which ownership structures are more conducive to exporting.

Controls

C1: the official reported level of industrial decline (measured as the corresponding industry's reported decline in real output over 1993-1996, as a percentage of the 1993 level) shall be positively associated with exporting intensity and propensity, reflecting that a fall in domestic sales acts as a "push factor" for exporting.

C2a: firm size in year Y_{t-1} will be positively associated with exporting intensity and propensity in year Y.

C3: annual investment in year Y shall be negatively linked to exporting intensity and propensity in year Y.

H1: inside owners may have reason to block exporting strategy and thus lagged insider ownership shall be negatively associated with exporting levels.

H2: lagged outside ownership shall be positively associated with exporting.

H3: lagged foreign ownership shall be positively associated with exports

H4: a decline in state ownership in year Y_{t-1} will lead to an increase in exporting activity in year Y .

H5: lagged board representation of insiders can negatively affect exports, representing the entrenchment hypothesis.

H6: lagged board representation of outsiders can positively affect exports, representing resource dependence roles.

H7: lagged board representation of foreign owners can positively affect exports.

H8: the lagged interaction of outside share holding and percentage of board seats can be expected to have a positive affect upon exports.

H9: a change in directorate can be expected to positively affect exporting.

H10: the presence of a dominant owner in year Y_{t-1} shall positively affect exports in year Y .

H11: the presence of an outside dominant owner in year Y_{t-1} shall positively affect exports in year Y , as we can expect these kind of dominant owners to have more power and incentive to become involved in restructuring.

H12: institutional share-holding in year Y_{t-1} shall be negatively associated with exporting in year Y , in order to test if institutional investors are “pressure sensitive” and

H12b: institutional share-holding in year Y_{t-1} shall be positively associated with exporting in year Y in order to test if institutional investors are “pressure resistant”.

Chapter six examines the foreign partner selection process of firms by adopting logistic regression techniques. This chapter shall test the following hypotheses:

H1: exporting activity increases the likelihood of a firm having a foreign partner.

H2: firm size decreases the likelihood of a firm having a foreign partner.

H3: required investment levels increases the likelihood of a firm having a foreign partner.

H4: perceptions that foreign partners are seeking access to local markets via local production are positively associated with the likelihood of a firm having a foreign partner.

H5: perceptions that foreign partners are seeking access to local technology are negatively associated with the likelihood of a firm having a foreign partner.

H6: attitudes of firms in the former Soviet Union concerning access to technology from foreign partners is negatively associated with a firm having a foreign partner.

H7: attitudes of firms in the former Soviet Union concerning access to markets from foreign partners is positively associated with a firm having a foreign partner.

H8: managerial strategy geared towards domestic strategy is negatively associated with the likelihood of a firm having a foreign partner.

H9: managerial turnover is positively associated with the likelihood of a firm having a foreign partner.

H10: greater than average employee share holding is negatively associated with a firm having a foreign partner.

H11: greater than average foreign share holding is positively associated with a firm having a foreign partner.

Lastly, the determinants of retaining a foreign partner shall be tested with the following hypotheses:

Control 1: firm size is negatively associated with the probability of a firm retaining a foreign partner.

H1: capacity lost due to depreciation of machinery/equipment and permanent removal of workshops/plants is positively associated with the probability of a firm retaining a foreign partner.

H2: labour productivity¹⁸ is positively associated with the probability of a firm retaining a foreign partner.

H3: annual investment levels are positively associated with the probability of a firm retaining a foreign partner.

H4: gross job gains in existing and new production units is positively associated with the probability of a firm retaining a foreign partner.

H5: export intensity is positively associated with the probability of a firm retaining a foreign partner.

¹⁸ Approximated by total sales/no. of employees.

H6: profit is positively associated with the probability of a firm retaining a foreign partner.

H7: total liabilities (to banks, suppliers, utilities, government and wage arrears is negatively associated with the probability of a firm retaining a foreign partner

Chapter seven summarises the main findings, details several contributions and implications and suggests items for further research.

1.6 MAIN CONTRIBUTIONS TO INTERNATIONALISATION RESEARCH

Below several of the contributions to the internationalisation research are outlined below, and are explored further in chapter seven.

- Dosoglu-Guner (2001) notes that despite the effects of organisational culture and ownership type on a firm's strategic goals being well established, *"the framework in the context of export decisions has not been developed despite a possible link,"* (p72). Chapter five attempts to fill this void in the literature.
- Thus far in the literature there has been little research on the impact of privatisation on exporting in the former Soviet Union, so chapter five intends to fill this gap.
- Previous research has not used such a wide selection of ownership variables. For example Roberts and Tybout (1997) include only one dummy variable to represent ownership structure. While, Dosoglu- Guner (2001) only uses a description of organisational structure, such as adhocracy. My main contribution shall be to include a much wider view of the impact of ownership structure upon exporting in chapter 5. For instance I include continuous variables in order to represent the level of insider, outsider, foreign ownership, the extent of dominant group ownership, along with board structure.
- Having highlighted the importance of foreign ownership in chapter five and in the literature, chapter six shall examine which factors determine whether a firm has acquired a foreign partner, thus treating ownership as an endogenous factor, contrasting from the previous chapter. This follows the research of Demsetz and Villalonga (2001) and Bishop *et al.* (2001).

- Moreover, existing research on alliances has focused upon the characteristics of the developed country partner. My approach is to examine the presence or non presence of a foreign partner from the point of view of the *local* partner.
- Furthermore this study takes advantage of a unique dataset, which includes data from three countries of the former Soviet Union and captures firm level material over a period from 1994-1997.
- Lastly this study employs a wide variety of quantitative techniques such as WLS, logistic regression and repeated measures analysis.

CHAPTER TWO: THE INTERNATIONALISATION PROCESS AND THE OWNERSHIP DEBATE:

A LITERATURE REVIEW

2.1 INTERNATIONALISATION

The process of internationalisation is also a central theme to this dissertation, therefore this section shall seek to present some of the main studies described in the literature.

In the 18th century Adam Smith had emphasised the importance of trade as a vent for surplus and as a means to improve the division of labour and productivity. Smith (1776) in fact claimed that,

“(Foreign trade) carries out the surplus part of the produce of their land and labour for which there is no demand among them...”

Smith hints at a lack of domestic demand inducing an export drive among firms. This study will use a similar argument: industrial domestic decline will “push” domestic firms to look for foreign markets, as a reactive force, which gives us the following hypothesis, tested in chapter five (C1): industrial decline in year Y_{t-1} will be positively associated with exports in year Y .

Later, David Ricardo (1772-1823), the official founder of the comparative cost and classical free trade doctrine, used this theory to describe and account for world trade. In his model, international differences in relative production costs determine the pattern of international trade. This model relies on the law of comparative advantage, which states the following, *“countries specialise in producing and exporting the goods that they produce at a lower relative cost than other countries,”*. Begg *et al.* (1992) note that there several reasons why relative costs may differ in different countries, namely technology or productivity.

Their model assumes that there are two countries, the UK and the US producing two goods, videos and shirts. Also labour is assumed to be the only factor of production and there are constant returns to scale. Perfect competition is also assumed, so the price of each good is equal to its marginal cost. If we assume that American labour is relatively more productive in videos and shirts then these relatively productivity differences are the basis for international trade (see Begg *et al.* (1992) p 588, for a more detailed treatment of the model).

In the nineteenth century there appeared to be a move towards a dialogue concerning the role of international trade in producing growth. In fact Alfred Marshall (1890) remarked that, “*the causes which determine the economic progress of nations belong to the study of international trade*,”. Moreover, scholars, such as Lewis (1980) almost a hundred years later, find a stable relationship between export growth and economic growth. The wide liberalisation of world trade under the General Agreement on Tariffs and Trade in 1947, stimulated a deluge of literature attempting to explain patterns of international trade and production. Some of the classic papers shall be described below.

Vernon (1966) emphasised the importance of the product cycle in determining patterns of international trade. At the first stage, an advanced country (he assumed America) develops an innovative (unstandardised) product and exports it to other advanced economies.

Eventually rivals will arise in foreign markets (Europe) and also begin to export as the product becomes more standardised. Now the original producer will have to decide- should it invest in Europe to commence international production? To decide he will have to examine locational advantages of foreign markets, production costs, the external environment and the price elasticity of demand. Investing in international production abroad will lengthen the product's life cycle. Vernon developed this theory to explain the behaviour of US multinationals in the post war period.

Both Hymer (1960) and Dunning (1973) explore further the circumstances under which a firm may chose to start production in another country.

Hymer highlights several factors that affect the behaviour of firms considering international production or direct foreign investment. Firstly, he argued that multinational firms exist due to market imperfections arising from economies of scale, credit advantages, market structure, and networks of distribution. If transaction costs are too high for intermediate inputs, owing to imperfect market then firms will be forced to replace market transactions with internal transactions. Thus, internalisation will arise when it is difficult to enforce contractual arrangements (usually on leasing technology or knowledge) so that knowledge or a technology can be kept within the firm's boundaries.

Hymer also uses industrial organisation theory to show that if firms posses a certain advantage it may cause them to pursue international operations. These advantages in the home country, relative to a foreign market could manifest themselves as low cost factors of

production, a differentiated product, efficient distribution facilities, top managerial skills and access to cheap finance. A firm's advantages may be more prolific in a foreign market, than at home for instance, if the foreign country has less entrepreneurial skill, competition and access to capital markets, inducing international production.

Lastly, Hymer develops diversification as a minor motivation for international operations: if profits in one line of activity are negatively correlated with profits in a different line of activity, there is reason to diversify. Firms that engage in both activities, one of which may be abroad, will reduce risk of investment.

Hymer concluded that international operations may occur for many reasons, yet it is impossible to predict their form.

Dunning (1973) attempted to integrate these three approaches of industrial organisation theory, internalisation and location theory, and is now more well known as the "*eclectic approach or OLI paradigm*". According to Dunning, three conditions determine the presence of international operations abroad.

Firstly, *ownership* factors, or advantages specific to the firm, which outweigh the costs of moving production to foreign markets, and are superior to characteristics of firms in the host country. These advantages could be patents, strong brand names and technological superiority.

The second determining factor, perhaps the most important for Dunning, is *locational* advantages of the host. These may be an unsaturated market, low factor costs and a stable political and economic environment.

Lastly, benefits from *internalisation* must accrue to international production, as opposed to licensing, which will reduce transaction costs in imperfect markets.

Many other attempts have been made to explain international production: Mundell (1957) proposed that trade and capital movements are actually substitutes for each other, and Kojima (1978) although criticised, in some ways confirmed this by finding that Japanese FDI had been trade-creating, while US FDI had been trade-destroying. Other theories have centred round *differential rates of return*, which states that FDI will occur in countries with high rates of return, as opposed to countries with low rates of return. Thus international capital movements can be explained by differences in interest rates between countries. While

this cannot explain why countries with high rates of return undertake outward foreign direct investment, it could explain why FDI has so far been low in Russia, Ukraine and Belarus. International capital movements can also be explained by different tax rates amongst competing countries for FDI. For example, Lankes and Venables (in Zecchini, 1997) find that tax incentives are an important motivation for potential investors in the region of Central Europe and the former Soviet Union.

By the late 1970's a new theory of international trade had been borne, that of Heckscher Ohlin¹⁹, which stated that international trade is driven largely by differences in countries' resources.

Krugman and Obstfeld (1994) note that the model shows that comparative advantage is influenced by the interaction between nations' resources (the relative abundance of factors of production) and the technology of production (which influences the relative intensity with which different factors of production are used) (p64). Again the model is based on several important assumptions: each economy is able to produce two goods (cloth and food), and each requires the use of two factors of production which are in limited supply-land and labour. Also, each factor of production can be used in both sectors. Furthermore, the technology of production is one of fixed coefficients, i.e. there is only one method to produce each good. However the production of food and cloth is not expected to require land and labour in the same proportions, thus cloth can assumed to be labour intensive, and food to be land intensive.

Their model (illustrated on pp66-7 of Krugman and Obstfeld,1994) finds that an economy with a high ratio of land to labour will be relatively better at producing food than an economy with a low ratio of land to labour. Or, *"more generally, an economy will tend to be relatively effective at producing goods that are intensive in the factors with which the country is relatively well endowed,"* (p67).

Although the Heckscher-Ohlin model is one of the most influential theories in the study of international economics, empirical testing has revealed that countries do not export the goods that the theory predicts.

¹⁹ This is one of the most influential trade theories, and in 1977 Bertil Ohlin, a Swedish economist won the Nobel Prize in Economics.

It is well known that the US has a high capital-labour ratio, thus one would expect the US to export capital goods and import labour intensive goods. However Leontief²⁰ (1953) found the opposite result: US exports were less capital intensive than US imports, illustrating the famous Leontief paradox.

The number of assumptions and the fact that world trade patterns do not always exhibit the patterns explained in the theories discussed above has led many economists to develop new trade models.

Krugman (1983) states that most of the world's trade in manufactures is trade between industrial countries with similar relative factor endowments. Also most manufacturing industries experience increasing returns and are in some cases imperfectly competitive, characteristics which standard trade theory do not allow for. Thus he suggests two other models.

Firstly is the theory of intra industry trade which includes scale economies along with comparative advantage as a cause for trade. In this theory two types of trade are mentioned- inter industry trade based on comparative advantage and intra industry trade based on economies of scale. The industrial structure of a country's production will be determined by its factor endowments, however because of scale economies each country will only produce only a limited subset of the products in each industry, exhibiting a pattern of *intra industrial specialisation*. As a result each country is a net exporter in industries in which it has a comparative advantage, but now due to inter industry specialisation each country will also import some of the products in industries in which it is a net exporter. Therefore there will be intra and inter industry trade.

As Krugman concludes, the theory of intra industry trade provides "*a neat explanation of the empirical puzzles posed by manufactures trade among the industrial countries,*" (p344). Furthermore it provides an explanation for the puzzle of why similar countries trade so much and why a large proportion of this trade is a two way exchange of similar products. Second is the theory of technological competition which has emerged from the literature concerning the trade of manufactures where Research and Development (R&D) plays an important role. As a consequence of R&D, countries may engage in protectionist or interventionist policies.

²⁰ Bowen et al. (1987) found a similar result for a multi country data-set.

With this model it is assumed there are only two firms in the industry: one foreign and the other domestic. It is supposed that these firms compete on the grounds of technology either investing in R&D to decrease costs or develop new products, or both. Expenditure on R&D will determine their position in future competition and markets. The end result of the model shows that a protected home market can give a high technology firm an advantage in export markets or *“in other words import protection will turn out to be a form of export promotion”*.

Introducing technological competition into trade theory is particularly useful as it allows us to see the reason and justification for industrial policies that have been adopted in countries such as Japan.

This thesis does not cover the disadvantages of trade. For a recent survey of this literature see Hillman (2003).

The primary focus of this study is to attempt to examine the determinants behind the firm's decision to internationalise (export and select a foreign partner). The section below will present factors of internationalisation in other studies.

Which factors induce firms to internationalise?

According to Hitt *et al.* (1999) when a firm sells products outside the firm's domestic market, it is pursuing an international strategy- but what are the motivations for doing this?

Hitt *et al.* note four deciding factors.

Increased market size

By producing goods for international markets they can enlarge the size of their potential market. This may be an option for firms operating in markets with saturated demand, for example the US soft drinks market.

This could explain firms' decision to internationalise when the level of domestic demand is low, due to transformational recession. This idea is tested in chapter five.

Return on investment

Firms that operate in R&D intensive industries have a tendency to produce for international markets as larger markets may be a critical factor in achieving a return on investments. Also

as the market for new technology is getting bigger investments need to be recouped on a much faster scale, and larger markets provide an opportunity for this.

Location advantages

Lower costs of production are an obvious deciding factor, e.g. other countries may have cheaper labour, energy or raw materials. Again, for the countries in this study, this argument may not hold. As shown in the table below, Russia, Ukraine and Belarus all have relatively low US dollar wages, yet inward FDI remains low. However, Western markets may offer other locational advantages such a stable legal framework.

Table 1: US \$ actual wages for selected transition economies (monthly)

US\$ actual wage	1995	1996	1997
Russia	107	165	175
Ukraine	60	82	82
Belarus	101	83	79
Czech Republic	296	341	332
Romania	102	105	87

EBRD Transition Report, 1998, p66.

Economies of scale and learning

With the expansion of production into international products companies may be able to reap economies of scale and learning. Hitt also shows that firms may be able to exploit core competencies²¹ and encourage knowledge sharing between production units across countries, creating synergy across firms.

An earlier study by Czinkota and Ronkainen (1988) claims that activities on international markets may allow the firm to increase its output and “*climb more rapidly on the learning curve.*”

They also divide major motivations for internationalisation between proactive and reactive as shown below.

Major motivations for internationalisation

- * **Proactive**
- * profit advantage
- * unique products
- * technological advantage

- * exclusive information
- * managerial urge
- * tax benefit
- * economies of scale
- ◆ **Reactive**
- ◆ competitive pressures
- ◆ overproduction
- ◆ decline in domestic demand
- ◆ excess capacity
- ◆ proximity to customers or transport.

Proactive motivations stem from strategic change.

The promise of a profit advantage is often a strong stimulus to seek international markets: managers may perceive international sales a source of profit. This will obviously depend on managerial characteristics such as their perception of risk or inclination to internationalise. Terpstra and Sarathy (1997) document a case study concerning an Italian firm, Marzotto, which adopts an international strategy, with a main motivation being profit. By diversifying its manufacturing base to Germany, it has achieved improved financial performance, and has seen net profit increase from 10.2 to 20.4% of sales. This will be the basis for one of the assumptions of my study: firms undertake exporting to improve performance.

Interestingly, Bonaccorsi (1992) gives us reason to believe that exporting may be the easiest path for company growth:

- domestic market expansion in specific sectors may demand investment in advertising and promotions which may be beyond the financial resources of smaller firms.
- terms of payment are sometimes superior to that of the domestic country: this could apply in some transition economies.
- there may be credit discounts, subsidies or exemptions for exporting firms.

The possession of a technological advantage or unique products may induce firms to seek foreign markets. If a product is unique or uses a specialised production technique then it is likely it will have a competitive edge abroad. In the long run other firms will innovate,

²¹ See Hitt (1999) Chapter 3 for a description.

removing the original innovator's competitive advantage. There are parallels with this and the product life cycle theory of Vernon.

In the medium run, exclusive market information may act as stimulus. If a firm has knowledge about foreign customers, market places, distribution, special contacts etc. that other domestic firms do not have, it may be a good to exploit this before competitors catch up.

Managerial urges are often a good explanation for internationalisation: they may desire to pursue international markets for prestige and more autonomy, or they may simply be more "cosmopolitan" in their outlook.

Government attitudes to international activities may also play a motivating role: if the state offers tax benefits or credits to assist exporters then it more likely for a firm to consider international markets. For example in late 1980's the US government through the Department of Commerce established export trading companies and foreign sales corporations to encourage small and medium firms to increase their export intensity.

However, Czinkota and Ronkainen claim that proactive firms are more likely to be successful in exporting activities, compared to reactive counterparts: this will have interesting ramifications for the success of firms in Russia, Ukraine and Belarus.

Safety valve activities in times of a domestic business cycle decline can serve as a major motivation. Export sales may be stimulated by a fall in domestic price level, and then terminated when market demand reappears. This "hit and run" attitude into foreign markets can be met by some acrimony by foreign governments. Russian exporters cannot be accused of this behaviour before transition due to the "preisausgleich" or price equalisation system. This meant that the price exporters received for their products (purchased by the Ministry of Foreign Trade) remained relatively stable- or at least were not subjected to fluctuations by market demand²².

A saturated domestic market may also induce the same results to prolong the product's life cycle.

Excess capacity may also encourage internationalisation: if labour and equipment is not fully utilised then expansion into international markets could be seen as an attempt to distribute fixed costs on a larger base. If fixed costs have already been sunk in domestic production

then the international pricing scheme can be based on variable costs, yet this could have serious implications for charges of dumping exports.

A proximity to customers is also likely to play a role in export activities, this is the concept of “psychic distance”²³. It has been shown that in some cases geographical distance is not nearly as important as cultural distance. For example, some US firms feel closer to the UK than Mexico despite the huge geographical distance, due to common language and customs. Managerial attitudes towards exchange rate risk and the tools they have to protect themselves against currency related risk will also effect their decision to internationalise. Firms carrying out transactions in foreign currencies will be exposed to transaction exposure from outstanding contracts in payables or receivables. In western economies three tools are implemented to protect against exchange rate risk: firstly, risk modifying by increasing prices, secondly, self insuring by manipulating lags in contracts in anticipation of currency revaluations, and lastly shifting risk by purchasing futures or options. Managers in transition economies often lack these tools (particularly futures or options markets) so this may be a major factor preventing firms from undertaking foreign operations.

Bilkey and Tesear (1977) also propose another reactive reason for a firms decision to begin exporting: the unsolicited order, which acts as a “pull factor” into internationalisation. There are parallels with this idea and that of serendipity mentioned in the work of Meyer and Skak (2002), who find that chance or luck sometimes leads Danish or Austrian firms to enter Russian markets.

Other external factors also can determine the internationalisation process of the firm, in particular the type of foreign trade regime in which it operates in and subsequent policies, or more importantly for the transition economies, the government’s attitude to trade liberalisation.

Brenton and Gros (1997) emphasise the effect of institutional factors on trade reorientation from former CMEA to EU markets. Those transition economies (namely the former republics of the former Soviet Union) which concentrated their trade flows to the CMEA²⁴, suffered a greater decline in trade volumes. Enterprises in these countries were “effectively isolated from the west” and can be expected to face serious constraints when attempting to

²² See A. Smith (1993)

²³ Johanson and Vahle (1977).

reorient trade. Brenton and Gros propose that improvement in the quality and product design is a prerequisite for export expansion to western markets, yet their empirical evidence refutes this and shows that the failure of some FSU countries to export lies with governments' attitudes to liberalisation.

Lal and Rajapatirana (1987) also examine the impact of foreign trade regimes in developing countries. They report that a NBER study (Bhagwati, 1978) quantifies the effects of alternative trade regimes on dynamic factors that affect a country's growth rate. He shows that none of these factors benefit from import substituting regimes²⁵ suggesting the alternative, export promotion strategy. Aw and Hang (1995) document similar findings, in that those developing countries which pursue export orientated trade policies generally outperform those choosing to adapt import substitution policies. More recently, Thirlwall (1999) also shows that those economies which are more "outwardly orientated" are associated with higher levels of economic performance²⁶.

Thus for the transition economies the trade regime selected by the government is likely to affect the decision of firms to export or not. If the government adopts "strongly outward orientated policies" with very few foreign exchange controls and supportive industrial policies for export promotion the propensity of firms to begin exporting will increase.

Characteristics of exporting firms

This section intends to review the extant literature on general characteristics of firms at the beginning of their internationalisation process i.e. when they commence export activities. Leonidou and Katsikeas (1996) present a comprehensive review of the "microscopic approach" to export behaviour, as opposed to the effects of the macroeconomy. They present the core findings of 12 researchers²⁷, one of the most common strands being the opinion that export operations are "an evolutionary and sequential process," which can be viewed as a series of incremental decisions.

²⁴ The FSU intra union trade was typically over 80% of total trade (Kaminski et al, 1996).

²⁵ For a description of import substitution and export promotion see Thirlwell (1999).

²⁶ The Lal and Rajapatirana paper documents the problems of finding correlations between export growth and economic growth, and recommends the use of a Granger-Sims causality test.

²⁷ Predominant studies being Cavusgil, (1986), Moon and Lee (1990), Barrett and Wilkinson, (1995), Crick (1995) and Johanson and Vahlne (1977).

For example, Johanson and Vahlne (1977) base their model on the *incremental* internationalisation process (IP) of Swedish firms and their establishment chain of international operations. They emphasise that internationalisation is the product of a series of incremental decisions which involves the gradual acquisition, integration and the use of knowledge in foreign markets. Their findings show that the development of the firm is in accordance with this incremental view:

no regular exports → independent representative → sales subsidiary → production.

This gradual order of development of international operations in individual countries is not limited to Sweden, according to Gruber, Mehta and Vernon (1967), who have documented a separate step process of internationalisation in the US. Johanson and Vahlne attempt to account for this “incrementalism” and find that the principle causes are a lack of market information, lack of knowledge of foreign culture or language, uncertainty and perception of risk: in brief, there is a direct relation between market knowledge and market commitment. Eriksson et al (1997) find that a lack of experiential knowledge will increase the perceived cost of the internationalisation process, and thus affect the mode of entry.

To enlarge this model it would be beneficial to examine the firm’s internationalisation process into numerous foreign markets, and appreciate that firms may be capable of using multiple entry modes to foreign markets. Also, the models ignores firms who may “skip” the elementary modes of entry for direct foreign investment, and fails to recognise that internationalisation is not stepwise, as some firms may refocus operations.

Previously, Bilkey (1976) had noted that as these firms move to different stages of the internationalisation process the factors that affect the decision to export change, this, he recommends has implications for government policy which must differentiate between the various stages.

Czinkota (1993) also adopts an incremental approach to internationalisation, yet the scope used is much narrower and only focuses upon the stages of exporting activities, not the entire internationalisation process. He identifies several “change agents” which lead firms increase their commitment to export activities, some of these can be applied to movements along the establishment chain advocated by Johanson and Vahlne above. Internal change agents can

be classified in to one of the following: managerial enlightenment, new management, over production/decline in the domestic market size and the acquisition of new information.

External forces may be an increase in foreign demand, persuasion by distributors or other agents who enjoy relational transactions with the firm or pro- export programmes initiated by government bodies.

Leonidou and Katsikeas (1996) also highlight several factors facilitating or inhibiting the decision to export: managerial characteristics and style, organisational structure, production capacity, tariffs and the access to information.

Management style can be expected to influence the exporting behaviour of the firm, if export management systems and planning procedures are implemented this will accommodate internationalisation. In addition, younger managers with foreign language abilities have been associated with internationalisation (Langston and Teas, 1976 and Pinney, 1970, Bilkey, 1973) Managerial commitment to resource allocation for exporting is also an important determinant of export behaviour. Firms with a high percentage of exports in sales can be characterised by a management team that commit large portions of organisational resources, such as financial capital, equipment and employees to internationalisation.

Boeker (1997) examines strategic change as a function of performance and managerial characteristics. The main variables that were examined were the tenure of the top management teams and the CEO. Boeker found that organisations with long tenured top management would exhibit less strategic change. This applies to the firms of the FSU, where organisations with long management tenure are more likely to harbour “Red Directors.” As already suggested above, in hypothesis 11 in chapter five, managerial turnover could be associated with export activity (as suggested by Filatotchev *et al.*, 1999).

Other research has examined the extent of management quality and exporting, Wisersheim-Paul, Welch and Olson (1975) report that exporting firms tend to have superior, more aggressive management teams.

Shama and Merrell (1997) have investigated the behaviour of Russian managers and claim that, “*increasingly Russia’s emerging managers have professional education, favour change, ..., and (are) market and consumer orientated, and entrepreneurial risk takers.*” As for managers from formerly state owned enterprises their main priority has been firm survival, but some are now actively seeking growth opportunities.

Puffer (1994) also documents similar findings suggesting that a growing number of managers are becoming more “market orientated”, one connected study showed that Russian entrepreneurs exhibit the same amount of achievement motivation as their American counterparts²⁸.

The innovation status of the firm has also been classified as a characteristic of an exporting firm, or its probability of being an exporter. From Wakelins’s (1998) analysis it is clear that for a sample of UK manufacturing firms, innovating and non innovating firms behave differently in terms of export behaviour. The Wakelin study uses a number of innovations, as opposed to the level of R&D expenditure, as a measure of innovation status. The main results from this study are that non innovative firms are more likely to export than innovators, however the number of past innovations is positively correlated with the probability of a non innovating firm exporting. This coincides with the product life cycle in the work of Vernon (1966): firms innovate and develop an unstandardised good and eventually export it.

The influence of firm size on export behaviour has featured heavily in the literature.

The predominant hypotheses that have been tested are:

H1: the probability of being an exporter increases with firm size and

H2: export intensity is positively correlated with firm size.

Aaby and Slater (1989) review 55 studies on size and they find that there is no agreement regarding the impact of organisation size on export propensity. Samiee and Walters (1990) claim that this conflicting empirical evidence is due to differences in contextual factors, such as industry, firm and market environments. In addition, there is not a general consensus on which variable should represent size: the number of employees, level of sales, volume of firm assets. Reid (1982)²⁹ suggests other size indicators such as the number of technical employees and the number of product lines should be used, in this study the number of employees is the chosen measure.

Bonaccorsi’s (1992) study based on a survey on the Italian manufacturing industry “*falsifies the proposition and challenges some widely held assumptions in export marketing literature,*” he finds direct evidence to refute H1: in Italy small firms are largely involved in

²⁸ Chirikova (1994) finds in contrast that leaders in formerly state owned firms are “*functionalist and inflexible, ..., they can only focus on routine problems,*” (taken from an excerpt in Puffer (1994).

²⁹ Reid, S, “The impact of size on export behaviour in small firms,” in Export Management, Czinkota and Tesar, eds. (1982).

foreign trade. Additionally, he presents some compelling arguments to suggest that H2 should also be rejected. Firms that operate in very high- tech industries or those that have a very high minimum efficient scale will be more likely to export, in order to recoup innovative expenditure and an attempt to enjoy economies of scale, regardless of firm size.

Bonaccorsi also notes that exports provide an opportunity for firm growth, yet he ignores the effects of firm size (employees or total sales) on foreign market entry behaviour: this would be a useful extension, for example firm size could affect the probability of a firm acquiring a foreign partner. This will be examined later in chapter six. Bonaccorsi also suggests that internationalisation is a “collective process” among Italian firms, with a *“high degree of co-operation within industrial districts...there is a high level of communication and of interpersonal relationships among entrepreneurs...”* Thus the decision to export can be based on the experiences of neighbouring firms.

Alfred Marshall was one of the first economists to deal with the issue of localisation . He noted that the concentration of many firms offers a pooled market for workers with industry specific skills, providing a lower probability of unemployment and labour shortage. Also localised industries can support production of non tradeable specialised inputs and furthermore informational spillovers can give clustered firms an improved production function.

More recently, Krugman (1991) examined in detail the reasons for concentration and agglomeration of firms. He develops a model which explains why manufacturing forms become concentrated in a few regions, whilst others remain relatively undeveloped. Yet, Krugman’s focus differs from Marshall’s, as it focuses upon generalised external economies, rather than a particular industry.

Krugman develops a model based on the monopolistic competition framework stemming from the research by Dixit and Stiglitz in the late 1970’s. In the model there are two regions and two types of production: agriculture which experiences constant returns to scale and is tied to the land region, and manufacturing, an increasing returns to scale sector which can be located in either region. The model also makes the strong assumption that transport costs of agriculture are zero, ensuring equal prices and wages in agrarian sectors, in both of the regions.

As for the behaviour of firms, due to free entry into the manufacturing sector, profits do not exist, leading to equal output per firm, in each region, regardless of the wage rate and relative demand. However, the number of manufacturing goods produced in each region is proportional to the number of workers.

Although the model does not include any dynamics Krugman does set out a brief concept of short and long run equilibrium. By examining the distribution of labour between the two regions he finds a trade off between proximity to the larger market and a lack of competition for the local market.

The model also seeks to explore whether worker concentration can be an equilibrium. It assumes that all workers are located in region one, now being a larger market in that of region 2. Krugman asks if it possible for a firm to produce profitably in region two. If not, then concentration in region one becomes the equilibrium.

The main result from the algebraic manipulation (shown on p494-7) shows a simple story. In an economy with high transport costs and weak economies of scale the distribution of manufacturing will be determined by the distribution of "*primary stratum of peasants*" (p497). Conversely, with lower transport costs and strong economies of scale or a higher proportion of manufacturing, circular causation and concentration will occur in which ever region gets a "*head start*" (p497.)

Krugman's study is useful as it shows how a country can become differentiated into an industrial core and an agricultural periphery by using transport costs and economies of scale. However, Neary (2001) criticises the new economic geography models on a variety of issues. For example, he notes that use and treatment of returns to scale maybe faulty, also the model does not allow the strategic interaction between firms, and lastly he claims that the model fails to account for the localisation of individual firms.

In Russia, co-operation may not be possible due to the sheer scale of the country, competing criminal networks and industrial concentration. Through the application of oligopolistic reaction or a bandwagon effect, managers may react to another rival firm, or indeed, any "near" firm's decision to export and follow suit.

Aitken's (1997) results differ from Bonaccorsi's: in Mexico the decision to export is not correlated with local concentration of overall export activity. This could hold true for Russia

too, regions are possibly too huge to allow for oligopolistic reaction. However, on an industry level, oligopolistic reaction may have some power, if a firm which is an industrial rival begins to export, this may positively affect the decision to export.

In this research, variables are not available for export planning, firm age,³⁰ managerial characteristics such as age and lingual aptitude, as they were not captured by the questionnaire. Instead, managerial tenure, investment levels, firm size, industry membership and one factor which has not been used widely in the literature: ownership structure. In chapter six, concerning foreign partner selection, managerial attitudes will also be considered, a variable which is rare in most studies of internationalisation.

It can be anticipated that *ownership structure* will have a much bigger role in determining if a firm undertakes export activity in transition economies. For example, a firm with a remaining majority state ownership may be less likely to export to non former CMEA countries, than a firm with widespread outside ownership. This factor has been ignored in a wide number of studies (see Dosoglu and Guner, 2001, for an exception), and shall be examined thoroughly in chapter five.

Entry modes

Entry modes are a “frontier issue” in international marketing according to Anderson and Gatignon (1986) as the choice of entry mode brings a variety of advantages or drawbacks. However, the trade off between control and the amount of resources committed is not easy to evaluate, as we shall see below, when transaction cost analysis is employed.

This section will aim to illustrate the main motivations for each entry mode, present a framework for examining market entry and section 2.5b shall present some of the critical issues presented in experiences of international joint ventures in Russia.

Reich and Mankin (1986) cite that technology transfer is often a sensitive issue when considering a joint venture because the partners’ interests may conflict and tension may arise when one partner has the incentive to access technology and the other has the motive to protect technology. This may breed potential antagonism.

³⁰ Ursic and Czinkota (1984) claim that younger firms are more disposed towards exporting activity, in transition economies it could be argued that younger firms are more likely to be unscathed by the former political system, and thus more prone to restructuring, this will be complex to quantify and thus shall not be followed up as an independent variable.

This has been illustrated by McCarthy and Puffer who show that some multinational enterprises (MNE's) are reluctant to invest beyond a limited amount required to establish a foothold, these organisations' conservative attitudes to the risk and uncertainty in the Russian milieu employ a much different strategy to that of MNEs with aggressive investment policy. While it is clear that not all MNEs behave in the manner hypothesised above, such as the fast-food chain, McDonald's and Coca Cola who have both followed a voluntary heavy investment strategy, there is definite evidence of large companies, namely IBM, which used a reverse incremental strategy of reversing their course and re-deploying assets. In 1996 IBM reduced its production presence in Russia, and reverted to exporting personal computers to Russia.

This may lead Russian firms to retreat to less "riskier" modes of entry such as licensing or non equity strategic alliances, if they fear that foreign partners will not fulfil their part of the agreement, this maybe one of the reasons why we see a decline in the number of firms with a foreign partner in chapter six. However, a trade off will occur: risk versus opportunities for R&D and technological transfer.

Motivations

Eramilli (1991) finds in his study that firms with low levels of knowledge desire higher degrees of control when entering foreign markets to reduce risk and perceived cost, yet higher control is likely to involve higher amounts of investment.

Terpstra (1997) recognises that the selection of method of entry to foreign markets depends on industry and firm specific factors particular to each firm which may be classed under the following:

- company goals: geographic coverage, time span.
- company size
- nature of product line
- competition abroad
- the degree of control and local feedback the firm requires
- investment requirements and the ability to raise finance
- length of profit horizon- does investment need to be recouped in the short or long run?

The next section shall deal with the main motivations for various entry modes:

1) Licensing agreements

This is a quick and easy method of entering a foreign market, which is suitable for firms who have limited funds for capital investment. Generally host governments favour this method over direct foreign investment, thus the need for meeting administrative and legislative demands are reduced. Additionally savings in trade barriers and transport costs will be acquired.

These benefits must be weighed up against the limited returns, lack of quality control and the fear of the licensee developing a competing product. However, despite these downfalls licensing agreements may provide a useful introduction to foreign markets for firms in transition.

2) International joint ventures (IJVs)

Harrigan (1988) describes how as business risks soar and competition grows more aggressive firms will embrace JV's with increased fervour. International joint ventures can assist a domestic firm to enter the global environment or find a new method of competing, in fact the creation of a JV is one method of gaining a competitive advantage.

Each partner of the operating JV must make a contribution in the form of capital, technology, marketing, personnel or physical assets and at least one must have access to distributive infrastructure. The resources that each party possesses will form the basis of its bargaining power when entering the JV. This could have serious implications for the balance of power in JV's in transition economies.

IJVs offer firms the opportunity to achieve greater returns from equity as opposed to royalties from licensing agreements. Firms initiating IJVs will also be motivated by greater degrees of control over production and marketing, as well as more feedback from local markets. Also there is more potential to exchange technology, managerial know how, equipment and local market knowledge between parties, this pooling of resources will help the progeny to develop new core competencies and synergy, which would not be achieved if the two firms operated alone. Thus each partner will be able to concentrate resources in those areas in which it has relative competencies while diversifying into other areas.

IJVs also provide a platform to overcome market imperfections yet they cause conflict between the two partners if their expectations are not met. They require high degrees of trust and co-operation and as Buckley and Casson (1992) point out “*the success of this mechanism will depend on how each firm is to ideas emanating from an alien culture,*” this may be particularly profound for the transition economies.

In short, Buckley and Casson (1996) summarise the conditions conducive to IJVs as the possession of complementary assets, opportunities for collusion and barriers to full integration.

3) FDI

It is well known that FDI by multinational corporations is considered to be a major channel for access to advanced technology by the developing world, it could be argued that outward FDI by transition economies will also benefit from this “contagion effect” from more advanced technology and management practices used by firms abroad. Bulatov (1998) studies the motivations for Russian outward FDI and found that one of the motivations is to rely on local partners for international experience, greater financial power, and highly qualified personnel.

Borensztein (1995) claims that technological progress will occur through a process of capital deepening in the form of new varieties of capital goods and practices, however for transition economies undertaking outward FDI, or developing countries accepting inward FDI, before advanced technologies can be applied, the presence of a sufficient level of human capital is required. Thus for FDI to be productive a minimum threshold stock of human capital must be achieved. By, examining levels of education (e.g. primary, secondary and tertiary) as a proxy for human capital it would be fair to say that Russia, Ukraine and Belarus have reached this minimum threshold, due to the high level of education inherited from the socialist era (see for example the World Development Indicators, 1997). Barro and Lee (1993) use a similar variable of human capital stock namely the average years of secondary schooling. If a firm has the ability to raise large amounts of capital finance, has successfully built up local knowledge, possesses contacts in the foreign market then it may be more suitable for an

internationalising firm to consider acquisition of an existing firm overseas. It has already been mentioned above, that a firm in a transition economy may hope to acquire some of these characteristics from the local firm.

However, if it fears resentment and upheaval from the local population it may be prudent to purchase a “green field site” which could provide spillovers to the local economy in the form of job creation and possible increased demand for intermediate goods and distribution channels. For example, a study by Borensztein et al (1995) shows that FDI favours the expansion of domestic firms complementary in production or by increasing their productivity by spillover effects from advanced technology. In addition FDI actually has a “crowding in” effect: a net inflow of FDI is associated with an increase in total investment in the host economy. In return, the investing firm will acquire a wider market access for growth and may increase its scope for efficiency seeking by finding cheaper raw materials.

Bulatov (1998) examines the motives of outward FDI, specifically for Russia. From his survey of 22 Russian companies in 1995 he found that the negative aspects of the domestic investment climate, excessive taxation and political instability, the desire to have a “spare business abroad”, to be close to foreign markets and the need to gain a competitive edge with a unique product, all motivate the decision to undertake FDI. These motivations may be common to other countries of the former Soviet Union.

Having discussed the main motivations behind various entry modes we can conclude that there is not an optimal method to enter a foreign market. To quote Terpstra (1997) “*the way best for the firm depends not only on its size, capabilities, and needs, but also on the opportunities and conditions in the target markets,*” It is imperative for the firm to examine its own situation to see how the characteristics above apply to itself.

A framework for analysing entry modes

A more rigorous approach to examining entry modes is the transaction cost approach.

Assuming that the aim is to maximise the return on investment of an entry mode, a theory of vertical integration can be used to generate hypotheses about the desirability of various entry modes.

Anderson and Gatignon (1986) show that the efficiency of an entry mode depends on four constructs which assist the determination of the optimal degree of control.

1. Transaction specific assets : investments that are specialised to one or few users or uses.
2. External uncertainty : the unpredictability of the entrant's external environment.
3. Internal uncertainty : the entrant's inability to determine its agents' performance by observing output.
4. Free riding potential : an agents' ability to receive benefits without bearing the associated costs.

These variables will be positively related to the entrants' degree of control.

The transaction costs analysis framework highlights the entry mode problem, the significance of uncertainty, balancing risks and the scale of operations. What it actively does is to offer a number of propositions for different governance structures, product lines and sociological distances to assist the managerial decision of how to select the appropriate entry mode.

Buckley and Casson (1998) extend the internalisation approach to foreign market entry, their model strives to improve on Dunning's eclectic paradigm by -

- encompassing all entry modes
- distinguishing between production and distribution
- accounting for strategic intentions between the entrant and the host

However, their main contribution is to introduce market structure and competitive strategy into the modelling of the entry mode decision.

The model encircles location costs, internalisation factors, cultural factors, market structure and competitive strategy. It derives a "profit norm" which represents the situation of acquisition with guaranteed local market knowledge, and then compares the costs of alternative strategies to this norm. By a process of elimination from their workings, only two strategies remain: greenfield production combined with acquired distribution, greenfield production combined with franchised distribution and licensing. Finally, a method to derive the propensity to adopt a given strategy is used, focusing on the rate of interest, set up costs and the cost of building up trust, post acquisition.

While this model appears robust, as well as flexible, that can be easily extended posses a dynamic dimension or be refined to analysing duopolistic rivals, it has been

shown that firms are not used to carrying out this particular kind of cost benefit analysis of each entry mode (see Robinson, 1978).

Few of the studies presented appear to integrate other modes of entry into the model, by recognising that exporting is the first stage of the internationalisation process³¹, this study hopes to improve on this. Firstly the determinants of exporting shall be examined Secondly the factors which determine the entry of foreign firms into Russia, Ukraine and Belarus, and how domestic firms select a foreign partner, shall be investigated. This, I would hope, give a broader outline of the growth and alternative strategies available to firms, within the scope of serving foreign markets.

2.1b EVIDENCE AND ISSUES CONCERNING ENTRY MODES IN THE FORMER SOVIET UNION AND OTHER EMERGING ECONOMIES.

This section will present some findings of studies based on experiences of IJV's and FDI. First, it would be enlightening to know how many firms used in this sample, from the University of Nottingham, have advanced from the first stage of internationalisation, and have initiated joint ventures, have gained inward FDI and undertook their own outward FDI.

The percentage of firms with a foreign investor could also be considered an advancement on the internationalisation path and thus shall be presented here.

Table 2: The levels of licensing, jvs and FDI in 1996 in Russia, Ukraine and Belarus

The percentage of firms who possess:	
Licensing agreement with a foreign investor	4.9
Joint venture agreement with a minority stake	5.1
Joint venture agreement with a majority stake	4.8
a minority stake in a firm abroad	0.7
a majority stake in a firm abroad	1.1
a foreign investor	34
seek a foreign investor	63

University of Nottingham database.

³¹ Those that do actively recognise this are Buckley, P, "The Foreign investment decision," Management and Bibliographies and review, 1979, and Johanson, J and Wiedersheim- Paul, F, "The internationalisation of the firm: four Swedish cases," Journal of Management Studies, 1977.

While it is obvious that the numbers of joint ventures and outward FDI have been low it seems that there is some potential for growth in this area: with almost two thirds of firms seeking a foreign investor.

An important issue described in the literature is that of the entry mode of multinational companies into transition economies. Bridgewater (1999) uses three strands of literature to understand entry behaviour of MNC's into Ukraine: economic based theories (oligopolistic reaction), incremental theory and network theory. She argues that network theory will make the largest contribution to the advancement of knowledge on entry behaviour. Furthermore, Bridgewater claims that economic based theories treat the firm as a "black box", that's to say that firm behaviour is dictated by market conditions and cannot explain divergent entry modes by firms in the same sector. Conversely, network theory views the firm as embedded in a complex web of interdependent relationships, which may impact on entry decisions.

Bridgewater uses Lee's (1993) distinction between external and internal interactions in international market entry as a framework. This means that all actors in the environment are considered, despite different traits, thus the environment becomes "*full faced*," (p102).

However, in reality, the changing structure of Ukraine's networks may make identifying potential partners difficult. An example of external interactions which may influence market entry is inter-organisational relationships, at home, in the host or other markets, these relations may be with other firms, suppliers or customers, or regulatory bodies.

Alternatively, at the inter organisational level, relations between different agents within the firm may shape entry mode decisions.

Using a Eisenhardt's structured case study approach, to ensure robustness of results, she finds that neither incrementalism, internalisation or oligopoly theory can fully explain entry behaviour (p113). In contrast, network theory is useful as new Ukrainian networks are emerging and can determine entry mode choices. From her case studies Bridgewater finds the following experiences:

"it seems impossible to carry out ...business functions without enlisting in the help of useful Ukrainian contacts," and that some firms have *"long standing relationships with counterparts in customer or regulatory bodies,"* (p114).

Manea and Pearce (1992) take a different approach and examine the strategic positioning of trans-national corporations in Romania. They adopt Dunning's (1993) categorisation of TNC activity: market seeking, efficiency seeking and knowledge seeking. A survey of TNC's operating in Romania allowed their classification into the three genres, whilst it proved difficult to allocate a TNC into a particular group, it emerged that one of the most strong reasons for investing in Romania was market seeking. Furthermore, their survey indicated that this strategic position allows them "*to help our TNC group to effectively extend the supply of its established products into Romanian and other CEE markets,*" (p13), whilst using imported standardised technologies (p22). Manea and Pearce (1992) conclude that this is a worrying finding as these TNC's are not generating localised creative competencies. For industrial transformation to take place dynamism and upgrading of resources are necessary, if standardised technologies are used they are "*likely to stifle rather than support change,*" (p23). This could breed antagonism and conflict, as Romanian firms may come to believe they are being used solely as an export platform, without the possibility of any benefits, such as technology transfer.

Indeed a major issue identified in the literature is that of joint venture success and conflict. Buckley and Casson (1990) discuss several solutions to joint venture conflict and mistrust. Firstly, they believe that the two parties should collaborate on *two* ventures instead of one. The function of the second venture is to counteract the mistrust by giving the least vulnerable party in the first venture, the greatest vulnerability in the second venture (p420).

Next they note that the role of co-operation is very important in solving conflict (p420), which may be a more efficient solution to creating another joint venture. It is the responsibility of the leadership of the firm to develop and corporate culture where a co-operative spirit is paramount. Also leadership must ensure that their employees behave co-operatively towards their counterparts in the other party.

Conversely, Newman (1992) examines determinants of success, rather than solutions to conflict and mistrust. Using evidence from IJV experience in China, Newman identifies several key factors contributing to their success. The main one being the *focused IJV strategy* which has five elements: 1) prescribed operations, 2) a narrow product line, 3) a sustained commitment of partners to the initial simple focus of the IJV, 4) motivated

employees who accept the character of the IJV and 5) strict performance standards for local suppliers. These guidelines emphasise the importance of maximising current performance and achieving good performance in the short run. While Russian managers may agree on the importance of the five rules, they may consolidate their fears that MNEs may deviate from their initial commitment and use IJVs as a transitional mode to eventually establish a wholly owned subsidiary. To reduce the probability of a conflict of interests the foreign partner must be explicit in its intentions and its time horizon to the Russian partner. Another method of ensuring success of IJVs is by assigning parent country managers to key positions in the IJV, suggest Geringer and Herbert (1989). In the case of Russia it will be relatively easy to find local managerial talents with local knowledge, connections and strong leadership skills. For instance, McDonald's in Moscow replaced all of its foreign managers by local ones and adopted its own training mechanism. Nevertheless, Russian managerial philosophy could pose problems in the case of Russian-US IJVs: Russian managers often put emphasis on task completion as opposed to product quality, this bad habit will have to be avoided to serve customers that now seek high quality goods. For the US partner these cultural factors ingrained in Russian managerial thinking represent an extra training expense or risk.

Banai *et al.* (1999) in their study of Russian - US joint ventures claim that in order to avoid conflict a mutual understanding of the other partner's position is crucial for a successful international joint venture. In short, *"the success of an international joint venture...depends on each partner's compatible objectives as well as their willingness to contribute complementary resources,"* (p18).

The Banai *et al.* (1999) study adopts a relatively new strategy, and investigates expectations of Russian managers on prospective IJV's. This is a similar approach to that taken in chapter six, where the perceptions of managers in host countries are examined. In their survey of 226 Russian managers they examine why IJV's are attractive to Russian managers, potential problems envisaged, the possibility of a focused IJV strategy, preferred equity structure and managerial philosophy. Their main results were positive, illustrating that motives are complementary, and perceived problems of each partner can be solved by the competencies of the other partner. Surprisingly, Russian managers agree to having 50-50 management composition of Russian and US managers, and recognise that their US

counterparts can facilitate the learning process (p32). However, there may be some conflict surrounding managerial philosophy, Russian managers tend to be autocratic and task orientated, while US managers are more people orientated and concerned with quality, both parties will have to adapt to these differing managerial styles and allow the qualities of each partner to be brought to the forefront. To conclude, the ideal IJV should draw resources and competencies from both partners, and make disclosure paramount, in particular concerning technology transfer, to avoid false expectations of host managers. Fey and Beamish (2000) claim that meta analysis of 12 studies on IJV failure showed that half identified conflict as the main culprit. Tilman (1990) finds similar findings for Japanese and Thai IJVs with the amount of conflict inversely affecting IJV performance. Fey and Beamish's work attempts to seek the determinants of such conflict. The conflict literature identifies several causes of conflict, the most common ones being: competition for scarce resources, desire for autonomy, goal divergence, and perceptual incongruities. It is the latter, perceptual incongruities in the form of differing organisational climate which Fey and Beamish emphasise. These organisational differences may manifest themselves as different modes of communication, differing levels of team work and formal control and attitudes to risk. Other researchers have found that inter-firm diversity restricts the firms' abilities to co-operate successfully, see Adler and Greene (1989).

In contrast, firms with similar organisational climate have a greater chance of avoiding conflict, as parents of IJVs will have aligned needs and assume lower agency costs. Through a series of interviews with top managers of Russian IJVs and a quantitative questionnaire, support for the following hypothesis was found- the greater the organisational similarity between the foreign parent and the JV organisation, lessens the propensity for conflict.

This supports the work of Harrigan (1988) who finds that corporate culture homogeneity among partners is more important than national culture homogeneity. Similarly Buckley and Casson (1990) find that cultural differences are a source of conflict, and will determine the degree of co-operation between parties. They postulate that it is more important to know the religion or cultural background of senior management, opposed to their nationality (p425).

Bridgewater (1999) in her case studies of Ukrainian IJVs find that networks and inter - intra organisational relationships must be forged to improve their chances of good performance, in order to compensate for disintegrated institutional relations and the “*confusion and disorder*”³² that has ensued over the last decade.

2.1C A SPECIAL CASE: FOREIGN PARTNER SELECTION

As we have seen above, conflict endangers IJV success. In the case of Russia the failure rate of IJVs has been high, notes Banai *et al.* (1999), in fact of the 4000 registered in 1993, only 20% were fully operational (p18).

A determinant of IJV success may well be the procedure undertaken to select a foreign partner. As Koot (1988) mentions foreign partner selection is difficult but critical to success of the international joint venture. The perceptions of what a potential foreign partner can bring in terms of technology, distribution networks and marketing etc. will obviously affect IJV performance. If one partner overestimates the potential positive qualities of a partner, this may lead to conflict.

Therefore, this is one of the reasons for examining foreign partner selection in the former Soviet Union in chapter six, where perceptions of local managers in relation to potential foreign partners, and their beliefs on how they are perceived by foreign partners are analysed.

By focusing on foreign partner selection from the local partner’s point of view this represents one of the first studies of this kind in the transition economics field, as Brouthers and Bamoussy (1997) note “*research that examines joint venture activities involving CEE state owned enterprises is still an underdeveloped area of inquiry,*” (p215).

Hitt et al (2001) had examined partner selection in three emerging economies (Mexico, Poland and Romania) and three developed economies (Canada, US and France). They hypothesised that there will be differences in partner selection criterion in the two types of market, owing to the resource based theory of the firm and organisational learning. Thus current resource endowments and needs motivate partner selection. For example, firms in emerging markets may seek a foreign partner “*to develop their capability to compete in*

³² Manninen and Snelbecker, (1993).

domestic and global markets,” whereas firms from developed economies may search for a partner “*with specific resources....to complement their own resource base,*” (p451). They then test a number of hypotheses on how much emphasis is put on various criterion of partner selection (access to finance, technological/managerial capabilities etc.) by managers from each type of market. By using hierarchical linear modelling their results show that partners are selected for access to resources and organisational learning opportunities and that context in partner selection is important (p461).

Firms in emerging markets value partners with access to finance, technical capabilities, intangible assets and a willingness to share expertise, more than firms from developed markets. While firms from developed markets value partners with access to unique competencies, access to markets and knowledge, more than firms from emerging markets. However, organisational learning is important for both groups of firms: both deem willingness to share expertise an important criterion in foreign partner selection. Lastly, Hitt *et al.* comment on points for further research, they note that foreign partner selection is a dynamic process and that motives for selecting a partner may change over time. We allow for dynamism and test hypotheses for presence of a foreign partner over a two year period.

Brouthers and Bamoussy (1997) take an alternative approach to examining partner selection: they look at the role of key stakeholders (the government) in international joint venture negotiations in Central and eastern Europe (CEE). They hypothesise that a key stakeholder can shift the balance of bargaining power during joint venture negotiations, and therefore are capable of changing the outcome of the process.

They claim that the government maybe a key stakeholder in CEE as it controls two major resources: ownership and “suasion”³³ and that it can influence the IJV formation in many ways. Firstly, it may affect the pre negotiation stage by signalling to potential investors which SOE’s are acceptable for potential IJVs. More importantly the key stakeholder may affect the industry structure to alter the bargaining power of the firm, i.e. by combining multiple segments into one firm (p289).

³³ Suasion is the ability to withhold a resource, which would end the negotiation process or lead to IJV failure. This could involve withholding access to a trading license, a market or a supplier. (p287).

In the negotiation stage the government may intervene at each step of the negotiation or wait until the post negotiation stage to act. In the final stage the stakeholder may “*demand changes in resource commitment, equity and control,*” (p290).

From eight case studies in Hungary and Romania they find that governments can have a direct and indirect influence on IJV formation, pre and post negotiation stages, yet their extent and type of influence is contingent on the context. For example, intervention is more frequent in strategic industries (telecommunications, oil and gas) than in consumer industries (food).

Some of their main findings indicate that in almost 40% of cases the government signalled all of its objectives prior to contact with a potential investor, furthermore, in some cases (gas and telecommunications sector) the government used its resources to influence the balance of power in the negotiations.

However, a more significant finding was that sometimes governments influence the IJV formation process to the detriment of their own SOE, which could become a source of potential conflict in later IJV success. Unfortunately, our data does not capture the role of the government in the foreign partner selection process, but this could be a possible route for further research.

2.2 PRIVATISATION AND OWNERSHIP

The roots of the debate concerning privatisation and property rights date back at least to the seventeenth century teachings of the English philosopher John Locke, who proposed that rights to personal property should arise whenever man “mixed his labour”, because “‘tis labour indeed that puts the difference of value on everything.” Locke³⁴ envisaged the right to property as a right to material benefits and also as personal rights included in, “lives, liberties and estates,” Over time this view has been employed as the foundations of political philosophy surrounding the ownership conundrum.

The fundamental concept that lies behind privatisation is the *transfer of ownership rights* from the state to the private individuals, with its aim as to diminish the state’s direct role in the day- to day running of the firm and essentially to “depoliticise” enterprise decisions and

³⁴ J. Locke (1632-1704) “Two treatises of government”, London, 1690.

create a new class of capitalists. Lavigne (1999) adds that in LDC's privatisation should also include the creation of an entirely new enterprise sector.

A Brief history of privatisation in the Twentieth century

Meggison and Netter (2001) provide an excellent survey of the literature on privatisation, and it is from their study that the next sections shall draw from.

They note that in the twentieth century the balance of private and state ownership varied in Western Europe and its colonies. Following world war two European governments became more active in the ownership of production, and those in developing countries increased their ownership due to their belief that state ownership boosted economic growth.

However, a privatisation programme was launched in the Federal Republic of Germany in 1961 by the Adenauer government, beginning with selling a majority stake in Volkswagen. More recently, in the UK, during the 1980's privatisation was established as a basic economic policy, as part of the Tory campaign, and by the end of the 1990's the role of state owned enterprises was reduced to virtually nothing. Other European governments also launched privatisation programmes during the same period, for example Chirac's government in 1986 privatised over 20 corporations.

Privatisation had also spread further afield to the People's Republic of China, which initiated several small privatisations in the 1970's, however the impact of privatisation was much wider and more successful in Latin America, for example, Mexico. As for Saharan Africa privatisation has not been widespread, although Nigeria has allowed public share offerings. The final region to implement privatisation programmes was the former Soviet bloc. In this area privatisation was part of many other economic reforms, as part of the transition to a market economy. As the population lacked savings, this shaped the method of privatisation, therefore mass privatisation programmes were common, which distributed vouchers to the population (see later sections in this chapter for details of privatisation programmes in Russia, Ukraine and Belarus another privatisation programme had been launched in the Federal Republic of Germany in 1961 by the Adenauer government, beginning with selling a majority stake in Volkswagen..

The goals of all these governments were broadly similar: to increase revenue for the state, promote economic efficiency, decrease government interference, promote wider share ownership introduce competition and subject state owned enterprises to market discipline.

Since the ownership structure of a firm has a large impact on its behaviour and performance we can expect a change in property rights to alter the underlying incentive structure and thus the behaviour of management simultaneously.

This can be succinctly illustrated by the principal and agent relationship and the subsequent problems that arise (Jensen and Meckling, 1976, is the seminal paper) Agency problems are likely to occur whenever:

“The directors of such (joint stock) companies, however, being the managers rather of others people’s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in private copartnery frequently watch over their own.... Negligence and profusion therefore must always prevail...in the management of the affairs of such a company”

Adam Smith, The Wealth of Nations, 1776.

Or, in brief, a “separation of ownership and control³⁵” in large corporations and other organisations, namely financial mutuals, non profit organisations and partnerships give rise to these agency problems.

Simultaneously it must not be forgotten that the creation of the publicly held corporation did bring serious advantages, that have been responsible for the economic growth of much of the West (see Rosenberg and Birdzell, 1986.) From 1895-1945 a revolution was experienced in economic organisation with the discovery of advantages of investment in corporations with easily marketable shares. Through the growth of commercial law and the abolition of the necessary royal charter the modern business corporation or the joint stock company was born. By 1834 joint stock companies became legally recognised bodies and 1856 saw registered companies gaining limited liability, thus by the end of the nineteenth century limited liability was a normal practice. Limited liability ensured that a member’s

liability was restricted to their investment. The main advantages of this enterprise form is that investors are able to spread the risk of investment by small and marketable shares and are also able to express dissatisfaction with management by selling shares and reinvesting. The incorporated company did not end the organisational experiment, in fact this was only the beginning, to follow came the evolution of the multidivisional structure, take-overs, franchising and decentralisation.

The organisational revolution that occurred in the Soviet Union involved the transfer of ownership to the state, not investors. At the moment these countries are undergoing another “revolution” of trying to reverse this process.

Privatisation with the aim of transferring ownership from public to private hands led to differences in the relationship between management (the agent) and their principal (formerly the government, and now the entrepreneur) which implies a change in the relationship between those responsible for firms decisions and the beneficiaries of its profit flows. These differences are enhanced by the pre privatisation characteristics of Soviet enterprises:

- principals did not seek to profit maximise.
- absence of market of corporate control
- non existent bankruptcy constraint on financial performance.

It could be argued that the principal -agent problem in Soviet enterprises in some ways was similar to that of the Western world with Soviet managers seeking perquisites and following self interested paths of behaviour inducing a residual loss (there will be a divergence between the agent’s decisions and the decisions that would maximise welfare of the principal, in this case the government.)

McFaul (1995) documents that agency dilemmas were acute in the Soviet era between the Party State (principal) and the enterprise directors (agent.) Despite being a command economy the interactions between the State and its agents were based upon a contractual relationship. Yet as the number of transactions increased the State found it harder to monitor the agents and developments, throughout the Brezhnev era allowed directors to assume more control of enterprises, and a rise in “grey” behaviour, such as production skimming and

³⁵ See E. Fama and M. Jensen (1983.).

shirking, leading to uncertainty and goal conflict, which are some of the main characteristics of the agency relationship.

One problem which was bound to occur after the collapse of the Former Soviet Union was the emergence of managers behaving according to satisficing models, as first suggested by Williamson, whereby managers tend not to focus on maximising profits, but maximising his utility function consisting of a factors such as salary, size of workforce and perks.

An agency relationship can be defined as a contract under which one or more persons, the principal, hires another person, the agent, to perform some of the decision making activities in the firm, which serves as a nexus for contracting relationships. The only difference in the former Soviet Union is that the principal does not hire the agent - the director is already in place in most firms, remaining from before the privatisation process. If we assume that both parties are aiming to maximise utility then it can be anticipated that the agent will not always act in the best interests of the principal. The only way the principal can limit the residual loss, or the divergences from his interests is by creating an incentive structure for the agent and by incurring monitoring costs, as suggested by Alchian and Demsetz (1972) to reduce the self interested motives of the agent (in Alchian and Demsetz the emphasis is on the monitoring workers in team production.) In addition, it may be in the principals' best interests to pay a bonding cost to the agent to guarantee that he will not take actions that are detrimental to the firm. Regardless of the principals' efforts it will be impossible for him to ensure that the agent will make optimal decisions to guarantee the maximisation of the principal's welfare. Thus we can summarise agency costs as the sum of monitoring costs, bonding expenditure and the possible residual loss.

It can be expected that agency costs will become particularly tense in Russia, Ukraine and Belarus when insider dominated firms begin to sell shares to outsider owners, in the anticipation of assistance with restructuring, at the cost of control. Thus a trade off exists for the principal, between finance from equity markets and a loss of control. Agency costs will then be derived from the divergence between the insider owners and the outside shareholders' interests, since the principal will reduce the proportion of costs of any non pecuniary benefits.

As Jensen and Meckling note, as the owners- manager's fraction of equity declines his residual claims on the financial outcome declines, in turn he will increase his self interested activities and award himself more perquisites. Outsiders may realise that they will have to bear monitoring costs to prevent this, which will be reflected in the share price. The effects of managerial ownership on market valuation of the firm have appeared in the literature in two articles, by Berle and Means (1932) and Morck, Shleifer and Vishny (1988). Berle and Means claim that if management hold *too little* equity and shareholders are sufficiently dispersed then inadequate monitoring of firm value maximisation will ensue. Morck *et al.* use piece-wise regression wise to find that the relationship between managerial ownership and market valuation, using Tobin's Q as a proxy, is non linear, with medium levels of managerial ownership being associated with a fall in Tobin's Q and high levels of managerial entrenchment. Possible reasons for this lie with the fact that at medium levels of managerial ownership (5-25%) managers do not have the incentive to pursue firm value maximising objectives or they may be colluding with board members. In contrast, at low levels of managerial ownership(0- 5%) managers may have the incentive to maximise Tobin's Q in hope of promotion or the right to purchase more shares.

The agency relationship model of Jensen and Meckling (1976) illustrates the reduction of the market value of the firm caused by the owner-manager's consumption of perquisites or self interested behaviour.

In their model, $X = \{x_1, x_2, \dots, x_n\}$ is defined as a vector of quantities of all factors and activities within the firm, from which the manager derives non-pecuniary benefits. $C(x)$ is the total cost of providing any given amount of these items and $P(x)$ is the total dollar value to the firm of the productive benefits of X . Lastly, $B(x)$ represents the net dollar value to the firm, ignoring any effects of X on the equilibrium wage of the manager. Thus, the optimum levels of factors and activities X are define by X^* so that:

$$\frac{\partial B(X^*)}{\partial X^*} = \frac{\partial P(X^*)}{\partial X^*} - \frac{\partial C(X^*)}{\partial X^*} = 0$$

We can then define F as the dollar cost to the firm of providing the $X-X^*$ factors and activities which bring utility to the manager, so in essence F is the current market value of the stream of manager's expenditures on non- pecuniary benefits.

V denotes the value or wealth of the firm, and as the paper is concerned with the consequences of the owner-manager selling some of the equity, equity is defined by α ³⁶. The Jensen and Meckling model then assumes that equity markets and buyer behaviour are rational, so that buyers will anticipate the increase in non pecuniary benefits of the manager. As a result, the new owner will not pay $(1-\alpha)V^*$ for $1-\alpha$ of the equity.

Thus the Jensen and Meckling theorem gives:

For a claim on the firm of $(1-\alpha)$ the outsider will pay only $(1-\alpha)$ times the value he expects the firm to have given the induced change in the behaviour of the owner-manager³⁷.

This means that the decrease in the value of the firm is imposed on the owner-manager, representing the residual loss or the agency costs accrued from the sale of equity to outsiders. Blasi *et al.* (1997) document the resistance of insider owners to outsiders with general directors making it clear that they are opposed the sale of stock to unknown outsiders. One interviewee claimed, *"If a foreign investor agreed to give us all the capital we need for control of the firm, I'm not sure I'd take the offer,"*³⁸. One of the reasons for this opposition to outsiders may be caused by the very fact that insider-owners must bear the cost of agency. Upon selling a fraction of the firm's equity to an outsider, $(1-\alpha)$ we can anticipate that the owner-manager's consumption of non pecuniary benefits will increase to F^0 , causing the value of the firm to fall to V^0 . Thus the buyer will not buy $(1-\alpha)V^*$ for his fraction of the equity, but $(1-\alpha)V^0$. This will represent a loss of pecuniary income for the owner manager of $(1-\alpha)V^* - (1-\alpha)V^0$.

In the above analysis we have made an important assumption, that outside owners will not monitor management behaviour, this assumption is then relaxed by Jensen and Meckling. The owner-manager's activities can be monitored by expending resources upon auditing, formal control systems, budget restrictions and the creation of an incentive system that brings the interests of the owner-manager and outside owners more closely in line.

However, it is of no importance who actually makes the monitoring expenditure, the owner-manager could expend resources to guarantee to outsiders that he would limit his expenditure on F - these are termed *bonding costs*. The results will be the same in the case

³⁶ Please refer to the paper for a full mathematical and diagrammatic treatment of the model.

³⁷ For details of the proof see, M. Jensen and W. Meckling," (1976.)

of outsiders undertaking the monitoring, with non pecuniary benefits falling to F". The manager will be willing to carry out these costs if the net increment in his wealth from the increase in the firm value is greater than the loss in welfare from foregoing perquisites. The optimum position will occur where bonding expenditures and monitoring create the same outcome. In the transition environment bonding costs maybe related to the cost of entering the stock exchange or financial auditing and disclosure.

The above analysis has shown that whenever ownership and control are separated agency problems occur due to the self interested behaviour of managers.

However, Fama and Jensen³⁹ (1983) show that in, "*complex organisations the benefits of diffuse residual claims and the benefits of separation of decision functions from residual risk bearing are generally greater than the agency costs they generate, ...*"

The reason for this lies with the fact that the separation of decision making and control contribute to firm's survival as better decisions will be achieved by delegating decision functions to agents who have specialised knowledge and access to financial capital, compared to many residual claimants.

The theme of the transfer of ownership to outsiders is a key element in this study and shall be returned to in later chapters.

2.2b The transfer of ownership: state control to private ownership

The objective function of the principal and agent will also be modified by the transfer of ownership from state to private hands. A characteristic of state control is that principals will seek to maximise economic welfare, not financial return. The conventional approach is to measure economic welfare in terms of per capita income, but in a transition context it may be wiser to think in terms of per capita consumption (see Lecomber, 1978). The principal's objective will be defined by some form of the social welfare function where $W = (U_1(x), \dots, U_n(x))$ which is an aggregation of consumers' utilities. Alternatively, the government may account for producers' utility and so attach different weights to consumer and producer welfare. In this case the government will know how the producer or consumer rates different

³⁸ Quotations from interviews come the Russian National Surveys, 1995-6.

³⁹ E. Fama and Jensen, (1983).

bundles i.e. if he ranks the outcome of decision A over B: or in the language of utility: $U(A) > U(B)$.

The behaviour of agents ultimately cannot be expected to differ under state or private ownership: in both cases they will pursue some self interested activities. However, the welfare of the agent under state ownership can be defined as: $U = f(F, B)$ where F is the consumption of non pecuniary benefit and B is the bribes paid to the principal for allowing these self interested activities. As the agent sets a “price” for his self interested activities some internal efficiency will be achieved under state ownership, at the price of high transaction costs.

In comparison under private ownership the agent’s welfare is: $U = f(F, \alpha, M)$ so, his welfare is not only dependent on non pecuniary benefits but the market value of the firm, as well as monitoring efforts. Without regulation⁴⁰ the objective function of the agent in private ownership will seek to maximise profit at the expense of social welfare (in the case of external effects).

One of the frequently cited market failure arguments in favour of state ownership is that there will be no adverse effects associated with dispersed share-holdings on monitoring and that governments can enforce appropriate incentive structures to intervene in decision making of managers⁴¹. In the case of dispersed share-holding shareholders will *free ride* and be unwilling to take costly actions, because they believe someone else will undertake this. Thus, for privatisation to improve performance it must provide a superior incentive system. Vickers and Yarrow (1988) acknowledge that privatisation improves internal efficiency at the expense of allocative efficiency unless some efforts are made to curb profit seeking behaviour by regulatory constraints. However their study may only be relevant to Western economies, and the utilities sector in particular. As Estrin (1994) notes, while the objectives of privatisation maybe the same in the East and West, issues such as a lack of domestic savings in Central and eastern Europe, the complexities of privatising land, and the sensitive issue of privatising large firms which in the past had provided social benefits, make the matter more complex, and thus the Vickers and Yarrow study may appear narrow in scope.

⁴⁰ See Vickers and Yarrow (1988). In fact the effects of ownership on enterprise performance cannot be isolated from the interaction of potential competition and the regulatory framework.

⁴¹ Nevertheless Shleifer and Vishny (1994) note that in the case of the former Soviet Union, state owned enterprises did not always cure market failures, and often were the cause of pollution.

Shleifer and Vishny (1994) look at the relationship between privatisation, corporatisation, restructuring and efficiency. They develop a model in which politicians and enterprise managers bargain over the decisions of the firm. Politicians are anticipated to derive political benefits from excess employment, for example the employees maybe union members and the government may wish to gain the support of the union. Their analysis suggests that a regulated private firm may have a higher excess employment level than a public firm. Thus for the privatisation of cash flow rights to lead to restructuring the politician must surrender all his control to managers and private shareholders. Furthermore, in an environment with no bribes (this maybe questionable whether this is the case in Russia) excess employment is lower under management control than under politician control. This reflects the critical role of coporatisation i.e. the procedure which transfers the control from politicians to managers, in order to stimulate restructuring.

Shleifer and Vishny also make an interesting conclusion concerning the study of the transition economies. They believe that in Russia and Central Europe policies which decrease excess employment are beneficial, even if they increase social transfers, as the inefficiency of former state owned enterprises is the greater social cost to be borne.

Meggison and Netter (2001) examine the economic theory and theoretical arguments for privatisation, and therefore their paper is referred to in this chapter.

The efficiency implications of the move from government ownership to private ownership is one of the key issues, and the theoretical arguments for advantages of private ownership of the means of production are based on the theorem of economic welfare. Under the following assumptions a competitive equilibrium is pareto optimal: absence of externalities in production or consumption, the product is not a public good, non monopolistic market and information costs are low.

Theoretical arguments for privatisation

- 1) Privatisation has the greatest positive impact in cases where the role for government in lessening market failure is the weakest. Yet the argument for privatisation is less compelling in markets for public goods and natural monopolies, or in markets where the role of competition is less.

- 2) Government ownership can lead to problems in defining the goal of firms, and may lead to other objectives than profit or shareholder wealth maximisation. Instead they may aim to maximise social welfare, which can be hard to measure. Furthermore governments often lack the ability to write complete contracts with their managers and develop incentives.
- 3) State owned firms lack the discipline that exists in private firms inflicted by markets and threat of financial distress.
- 4) Privatisation can possibly reduce a fiscal deficit, as governments can raise a huge amount of money by selling state owned enterprises.
- 5) Lastly, privatisation can help develop product and security market institutions, all of which are particular relevant for the success of privatisation in transition economies.

However, it should be remembered that government intervention in ownership can also be theoretically argued for, this maybe necessary for regulation of monopolies, externalises and help provide public goods, or more generally correct for market failure.

Empirical evidence on the public versus private ownership debate

The table below presents a brief summary of some of the research on this polemic in transition and non transition economies, included in the study by Megginson and Netter (2001).

Table 3: Research summary

Researcher	Key findings
1. Non Transition economies	
Ehrlich <i>et al.</i> (1994)	State ownership can lower long run annual rate of productivity growth by 1.7% -1.9%.
Vining and Boardman (1992)	Private firms are significantly more profitable than mixed and state owned enterprises.
Dewenter and Malatesta (2001)	Private firms significantly are more profitable and have less debt than SOE's
Ramamurti (1996)	Privatisation attractive for telecoms industry, less scope for improvements in airline and roads.
2. Transition economies	
Djankov (1999) (includes Russia and Ukraine)	Foreign ownership is positively related to enterprise restructuring at high ownership levels, managerial ownership is negatively related at intermediate levels.
Frydman et al (1999)	Privatisation is successful only when firm is controlled by outsider owners.
Claessens and Djankov (1999)	Concentrated ownership is associated with higher profitability and productivity.

Harper (2000)	Second wave of privatisation yielded improvements in efficiency and profits.
Tian (2000)	Corporate value declines with state ownership, then increases as state share reaches 45%.

Djankov and Murrell (2002) also review some of the privatisation literature in order to see whether privatised firms perform better than SOE's. In particular they mention the study of Frydman *et al.* (1999) who find that privatisation improves revenue growth by approximately 7% a year, whilst Carlin *et al.* (2001) find a positive relationship between privatisation and new product restructuring, in their study of 25 transition economies.

Methods of Privatisation

A key decision of the government when launching a privatisation programme is the method which to transform state owned assets to private ownership. As Havrylyshyn and McGettigan (1999) note, the method of privatisation is crucial for how agency problems are dealt with, as the empirical literature reveals that that start up firms are the best performers in terms of efficiency, whilst insider dominated firms appear to be the least efficient among the newly privatised (p3). For example, in the case of Russia, where workers or managers commonly received 51% of voting shares in their enterprise (under Option 2 of the privatisation programme), this led to the legalisation of a pre-existing structure of control, which is more closed to outside investors, than reformers would have originally liked (Shleifer and Treisman, 2000).

Generally, selecting the correct method can be a tricky procedure and involves several political considerations: the history of asset ownership, financial position of state owned enterprise, ideologies concerning markets and regulation, concerns of interest groups, ability to protect investors' property rights⁴², existing institutions and corporate governance systems, sophistication of potential investors, which parties should be allowed to purchase state assets.

Several popular methods of privatisation shall be outlined below (see Megginson and Netter, 2000) for more details⁴³.

⁴² Havrylyshyn and McGettigan (1999) comment that the protection of property rights is essential for privatisation process to be successful, they state that, "*owners must be assured of the right to use assets, to decide on their use by others and to profit from their use and sale,*" (p6).

⁴³ Estrin (1994 (chapter 2)) also mention 6 other methods.

- 1) Privatisation through restitution. This method has been the most widely used within the Czech Republic and is rarely employed out of eastern Europe. It is suitable for when land or property can be easily retraced to its original owners.
- 2) Privatisation via the sale of state property. Here the government trades its ownership claim for a cash payment, it can be done by direct sales where a state asset is sold to an individual, a corporation or group of investors. Alternatively share issue privatisation (SIP) can be used, where a government stake is sold through a public share ownership.
- 3) Mass or voucher privatisation. With this method eligible citizens can use vouchers that are distributed freely in order to bid for stakes in state owned enterprises or assets. This has been commonly used in Central and eastern Europe, where it has brought about fundamental changes in ownership structure.
- 4) Privatisation from below. This is carried out via the start up of new businesses, and can act as an important source of growth transition economies. In their review of privatisation Havrylyshyn and McGettigan (1999) state that start up firms maybe an alternative path for increasing private sector activity.

Djankov and Murrell (2002) in their detailed survey of enterprise restructuring in transition economies focus upon the speed of privatisation and performance of the economy. They find that there is no clear relationship between the speed of privatisation and performance: Poland was a relatively slow privatiser but a good performer, Russia was a fast privatiser, yet a poorer performer, whilst Estonia is an example of a fast privatiser performing well (p14).

Despite some studies showing mixed results for the impact of privatisation, it must be remembered that for Transition Economies privatisation is essential for enterprise restructuring.

It is this issue, privatisation in Russia, Ukraine and Belarus that we turn to now.

2.3 PRIVATISATION IN RUSSIA.

Privatisation under the rubric of structural transformation has been regarded as a complement to stabilisation and liberalisation programmes. Already at the beginning of the

transition process it was understood that both liberalisation and privatisation would induce enterprise restructuring. Furthermore it was anticipated that privatisation would eventually improve enterprise performance, arising from a new incentive structure and a more advanced corporate governance system. As it stands the relationship between privatisation and restructuring is much more complex than first believed: although many industrial firms have been privatised (in Russia by the end of 1995, 17,937 medium-large sized enterprises had been privatised and by 1997 the private sector's share in GDP was 70%).⁴⁴ effective new owners and an adequate system of corporate governance had not been created⁴⁵. This phenomenon is not limited to Russia, the restructuring process has not been as far reached as hoped in other transition economies, as restructuring has mainly been reactive, focusing on downsizing and developing new products. Deep restructuring has been hindered by poor progress in institutional reform, failure to enforce a credible payments system and a lack of sound legal and financial institutions.

Evidence from the Business Environment and Enterprise Performance Survey⁴⁶

shows that the relationship between ownership and restructuring is complex. In Eastern Europe there are signs that privatised firms have restructured more extensively than state owned firms. Conversely, in the CIS state owned firms have surprisingly, in some cases, adopted new technology and expanded production more than privatised firms.

Additionally, in some cases post privatisation results have been unexpected, particularly in Russia. The Russian privatisation programme (see Blasi, *et al.* 1997 and Boycko *et al.* 1995 for a review of the design and results of the Russian privatisation process) at the first stage ensured that “managers and employees did not have to compete with anyone to buy this initial package of shares,⁴⁷” Thus, managers and employees managed to secure initial control. Western experts as well as the Prime Minister Yavlinsky both feared the domination of insider ownership, believing that workers would only be interested in guaranteeing their employment and securing high wages, while managers would seek to pursue self interested

⁴⁴ See Blasi *et al.* (1997) and EBRD Transition Report (1998).

⁴⁵ However, various measures were taken in the winter of 2002 in order to improve corporate governance in Russia. The Federal Securities and Markets Commission developed a voluntary code of corporate conduct, which details corporate governance norms, and aims to protect shareholders and investors. Yet Guriev *et al.* (2002) in the Transition Newsletter, Vol.12, No.6. points out that firms may need incentives to adopt these practices, as few managers have heard of the Code (p39).

⁴⁶ For details see EBRD Transition Report (1999), Annex 2.1, chapter 2.

⁴⁷ Blasi, *et al.* (1997).

activities and prolong relations with the nomenklatura, as opposed to undertaking restructuring activities.

A study by Buck *et al.* (1999) find interestingly that managerial and employee ownership is not always associated with retrenchment activities. Two of their key findings show that, “*non-managerial employee ownership does not afford employees a significant degree of decision control in the face of acute business crisis...*”

and,

“*No significant impact of managerial ownership on retrenchment in relation to capital assets is detected...*”

It appears that the fears expressed by some privatisation experts concerning insider ownership were in some cases unfounded, at least in the case of Russia. However, the remaining problem is if insiders are unwilling to sell shares to outsiders in order to enhance deep restructuring and allow a more dispersed structure of ownership?

2.3b The Russian privatisation programme.

As we have seen above privatisation is only a part of larger economic reform, but in Russia it was a rapid and ambitious programme so that by the beginning of 1996 77.2% of medium and large enterprises had been privatised. Under President Gorbachev in 1988 the Russian Supreme Soviet had adopted the preliminary laws for privatisation, manifesting itself as the Law on State Enterprises. This law intended to give autonomy to enterprise directors and allowed workers to elect management. The results were disappointing as no performance improvements were made, with no cost cutting efforts or any attempts to meet consumer demand were planned.

The Russian Law on Enterprises and Entrepreneurial Activity in 1990 had marginally more success allowing sole proprietorship, partnerships and closed and open joint stock corporations.

However, the end of 1991 marked the commencement of the Programme of Privatisation of State and Municipal Enterprise in the Russian federation, issued by a Presidential decree.

The degree covered land reform, mandating the transfer of property of collective and state farms, as well as liberalising trade.

Prior to the inauguration of the 1992 Voucher programme for medium and large enterprises a policy of “spontaneous privatisation” was applied to remove the power of the Soviet Cabinet Ministries from enterprises to award general directors more freedom in the day to day running of the enterprise.

Characteristics and principles of the programme

The seminal text in this area that shall be referred to is Boycko *et al.* (1995). The fundamental ideas behind the programme were the following:

- speed- to proceed quickly before the political window of opportunity closed.
- each interest group of society would be offered enough incentives for potential ownership which would in turn persuade the Supreme Soviet to pass privatisation law. In short, the aim was not to alienate any particular member of society (perhaps except the industrial ministries) to secure public support for the programme.
- simplicity- it was hoped that the design of the programme would effortlessly give incentives to all participants.

It has been remarked that the Russian *mass* privatisation programme ignored all economic principles (Pejovich, 1994) and failed to choose a method that would demand enterprises being sold to the highest bidder. This was implausible for political reasons and a cash sales method would be too time consuming and costly in terms of inefficiency.

This issue was at the crux of the debate of the privatisation programme in 1992: should a system of mass privatisation be used whereby insiders and the public are freely distributed property rights or a system of cash sales be used?

The idea of cash sales was appealing on three accounts: *“in cash sales, companies are either sold as a whole to the highest bidder, or else shares are placed in the market through a public offering.”*⁴⁸ This method has been associated with profits, productivity and even employment increases.

In efficiency stakes privatisation by sales guarantees depoliticization and transfers companies to the most efficient owners, which are not always the existing management, liberating enterprises from “Red directors.” Assuming that outside investors will participate they will be

⁴⁸ Boycko, (1995) p70.

willing and able to combat agency problems, assuring that the divergence of interests between management and shareholders is tackled.

Finally privatisation by cash sales provides much needed revenues for a transition economy attempting to balance revenues in a time of transformational recession.

Despite the attraction of the cash sales method it was dismissed in the Russian programme⁴⁹ on grounds that this method would not be politically feasible as the general public would not be catered for, with much of state property falling into the hands of foreigners, former party officials and nefarious business men. Additionally the cash sales method requires much preparation as auctions must be organised and much more importantly enterprises must be valued, which both requiring large amounts of resources and time.

Thus in 1992, led by Chubais a programme of mass privatisation, via vouchers distribution, which was initiated by presidential decree.

Some of the essential elements of the programme laid down by Boycko and his colleagues shall briefly be discussed.

1. Corporatisation

The programme divided larger firms⁵⁰ into those to be included in mandatory privatisation (light industry: textiles, food and furniture), those requiring the approval of the cabinet (larger manufacturing firms) and those firms that privatisation was to be prohibited (firms involved in natural resources and defence).

Firms that had achieved a certain level of employment and assets were to be corporatized. Corporatization demands that enterprises be re-registered as joint stock companies with 100% of equity being owned by the government, a corporate charter and a board of directors. The board would represent the government, general manager, workers and local government. This was a considerable step towards the subsequent privatisation process.

⁴⁹ And for this, was much criticised. See J. Rogozinski who claimed that the rejection of this method was owing to "Too much vodka!" *The International Economy*, 1993.

⁵⁰ The discussion shall be limited to medium and large firms, as this is the focus of this study.

As a result, corporatized firms came to be governed by their board of directors, liberating them from the tight reign of industrial ministries. Furthermore, by converting firms to open joint stock companies, guaranteed that firms did not become closed entities, being owned singly by workers and managers. Managers and workers were obviously against corporatization and demanded some form of compensation.

2. Insider benefits.

The government recognised that by providing benefits for managers and workers in privatisation would win political support, many managers hoped that by giving firms to themselves and employees would allow them to turn them into closed partnerships, thus preventing “interference” from outsiders. Insider control was also supported by many prominent politicians and western supporters of worker ownership (see Gates 1998).

Similar to the corporatization programme, workers under the direction of their managers had the right under privatisation to choose their own benefits option (see below). Managers were then required to submit a privatisation plan that outlined how the remaining shares would be sold, usually by voucher auctions or investment tenders. This feature of the programme appealed to managers as they had almost entire control on their chosen strategy for privatisation without the interference of government or ministry officials.

3. The details of the programme

Employees of each enterprise were allowed to choose one of three options, which transferred 40-51% of ownership to managers and employees. The remaining shares were then to be sold at auctions or at an investment tender.

- Option 1: allowed 40% of shares to be sold to workers, while the other 60% could be sold at an auction or held by the state. Workers were awarded 25% of shares (non voting) for free and could buy another 10% at 30% discount from book value. Managers could buy 5% at the nominal value. This resulted in minority employee ownership, 25% of enterprises chose this method.
- Option 2: allowed 51% of the shares to be sold to workers for 1.7 times the book value. Other shares could be sold at an auction, or by a pension plan, this had important implications for efficiency; the trading of vouchers and the use of investment funds have

helped create outsiders and blockholders. The liquidity of the voucher market ensured that in time core investors would arise in major companies. This secured majority employee ownership, 73% of enterprises chose this method.

- Option 3: was only applicable to only medium sized enterprises: and in essence was a management buyout by those willing to restructure the firm. A managing group including managers and workers would take responsibility for ensuring the firm's financial health and privatisation plan. Under this option the managing group could buy 30% of the shares and workers and managers could buy 20%. If privatisation and restructuring did not occur then the managing group would be forced to sell its shares. This option has been accused of being over complicated and thus seldom selected, in fact only 2% of firms selected this method.

After workers and managers had chosen their option, remaining shares had to be sold, the law specified that at least 20% of the shares be sold to bidders, the auction left 10-20% in the states' hand to be sold at a later date.

However, to make sure that certain members of society such as those employed in medicine, education, transport, students, KGB or agriculture were not alienated, the privatisation programme gave each citizen a voucher for 10,000 rubles to buy shares in any enterprise.

The auction mechanism⁵¹ was designed so that bids by individual citizens would have priority over banks, corporations and outsiders. But it was hoped that anyone could participate in a voucher auction, which made managers try to prevent outsiders from buying shares. It was believed that outside investors would undermine their control and enforce assertive restructuring policies.

Yet, this was exactly what the designers of the programme wanted: the creation of core shareholders who would own at least 5% of a firms total shares. These blockholders could be expected to have the incentives and power to monitor management behaviour closely and induce restructuring.

2.3 c What have been the results of the Russian Privatisation programme?

Meggison and Netter (2000) make an important point when analysing the effects of privatisation in Russia, they argue that the transition process has been more difficult for Russia compared to Central and eastern Europe, therefore it is harder to conclude on the results of the privatisation programme.

The first voucher programme was finished by 1994 involving some 15,000 medium and large sized firms which employed over 80% of the industrial workforce, and was in many aspects a success. The cash based phase of privatisation faced some obstacles, while the small and medium enterprise sector underwent privatisation, the firms from the large enterprise sector were subjected to stalls in the process. The government's programme for 1998 was to privatise 37 SOE's and sell blocks of 29 partially privatised firms, with a revenue target of \$3mn⁵². These plans were finally curtailed due to fears of devaluation and a collapse in the equity market.

Foreign ownership continues to be limited, particularly in the strategic industries. By 1997 foreigners owned less than 2% of Russia's medium and large enterprises. Insider ownership has appeared to snub any outside equity financing, particularly that of foreigners⁵³.

4. Governance and restructuring

Both governance and restructuring have been hindered by dominant insider ownership, even in cases where outsiders have a majority ownership, their holdings are so dispersed that the monitoring of management is sub optimal⁵⁴. Aututsionek et.al (1998) highlight that, "*proper mechanisms of corporate governance must create incentives or constraints on individual managers,*" as managers remaining from the previous system are unable to enforce restructuring activities following privatisation. Their research finds that poor corporate governance will lead to inefficient business development strategies.

In the longer term, it can be expected that outsiders will try to acquire core holdings which will allow outsiders to participate actively in decision making and the monitoring of

⁵¹ For a more detailed discussion of the mechanics of the voucher auction, see Boycko, p81-92.

⁵² EBRD Transition Report, 1997.

⁵³ At the end of this section a theoretical model shall be presented which illustrates the optimal level of outside ownership in a firm.

⁵⁴ Dispersed shareholders may be characterised by free riding and thus be unwilling to undertake the costs of monitoring.

managerial attitudes.⁵⁵ Shareholder activism may be developed by core holdings being acquired by investment funds, banks and other financial institutions in transition economies, improving governance from the threat of exit and active monitoring. In countries where corruption is rife institutional investors may collude with management teams, particularly if investors are relational⁵⁶ (whereby investors have ongoing business relations with the firm) or the institutional investor is pressure sensitive⁵⁷ to managerial influence. Additionally, Coffee (1996) notes that outside institutional investors may not be interested in long term efficiency, but short term income gains.

Nevertheless, the La Porta *et al.* (1999) study finds that the image of the modern corporation⁵⁸ is not as it appears in the seminal work of Berle and Means. In reality firms are not widely held, that's to say there is not a dispersion of ownership, unless they are situated in economies with a very sound legal system that protects minority shareholders. Thus at least in the medium term, in Russia, we can expect some degree of concentration of ownership, where "*these controlling shareholders are ideally placed to monitor the management*"⁵⁹, until a legal and regulatory system is built.

These studies all have serious implications for the optimal ownership structure in transition economies.

As for bankruptcy, the threat is very weak, by mid 1997 only a 1000 enterprises had been declared bankrupt. The reason for this is political opposition and a weak regulatory environment preventing creditors commencing bankruptcy proceedings. The new 1998 law, while much improved still favours the wishes of regional authorities at the expense of individual creditors. Much of the problem lies in the political sphere with the government often selecting enterprises for survival.

The lack of a credible bankruptcy threat has caused firms to rely on inter enterprise arrears and tax evasion. By late summer of 1998 total enterprise arrears amounted to 43% of GDP, stimulating a growth in barter. As a result market signals are dulled which delay the creation of incentives for further restructuring.

⁵⁵ Shleifer and Vishny, (1986).

⁵⁶ See Wagner (1998).

⁵⁷ Brickley, J, Lease, R and Smith, C, (1988).

⁵⁸ As envisaged by Berle and Means (1932).

⁵⁹ La Porta *et al.* (1999).

Enterprise restructuring is also in its early stages with most activities being “reactive”: achieved by changes in the product mix and labour shedding.

In the Blasi *et al.* (1997) sample managers and workers ended up owning, on average 65% of shares, with outsiders owning just 21.5%. From this, 11% of outsiders’ shares are held by blocks greater than 5%, and the rest are held by private individuals or investment funds. Evidence has shown that large shareholders will have positive effects for restructuring and corporate governance. For example, an outsider investor in Vladimir tractor works eventually gained full control and installed a new management team and Bioprocess coerced the management of Uralmash to agree to a far reaching restructuring plan.

As means of conclusion it is fair to say that the Russian privatisation programme has achieved a great deal: political control is in most cases reduced and some advances have been made to curb the activities of self interested managers, with some firms experiencing some degree of managerial turnover. What remains is for outside ownership to increase in order to develop scope for a more efficient system of corporate governance and plans for deeper restructuring. As Shleifer and Treisman (2000) state, Russia’s reforms have achieved many crucial successes, given the many political, economic and cultural constraints (p178). However, as Blasi *et al.* (1997) notes managers have been the “winners” of the privatisation process, and in some cases employee ownership has simply been a vehicle for managers to maintain property rights. Failing to separate ownership from management has had serious consequences for the Russian economy. Capitalist theory offers three solutions to this type of problem: firstly, managerial labour markets should act as discipline to prevent self interested behaviour, yet these labour markets do not function well in Russia, secondly shareholder discontent reflected by stockmarket exit can act as a serious disciplining factor to managers, but the Russian stockmarket is insufficiently liquid and lastly investment funds may have the incentive to monitor managerial behaviour, yet in the Russian case investment funds may not have superior knowledge to individual citizens, or may even consist of managerial personnel.

2.4 UKRAINE AND BELARUS

The privatisation programmes of Ukraine and Belarus were adapted from the Russian blueprint, but as we shall see in this last descriptive section the results were far from uniform.

Table 4: Progress and methods of privatisation of medium and large enterprises

	EBRD TRANSITION INDICATOR ⁶⁰	DIRECT SALES	VOUCHERS	MEBO ⁶¹
RUSSIA	3+	SECONDARY	PRIMARY	-
UKRAINE	2+	SECONDARY	-	PRIMARY
BELARUS	1	-	SECONDARY	PRIMARY

Source: EBRD, Transition Report, 1999.

Table 5: Privatisation results

	1994	1995	1996	1997
Russia				
Private sector share in GDP	50	55	60	70
Privatisation revenues as % of GDP	0.11	0.38	0.12	0.90
No. of firms privatised.	23,000	8,414	3,675	1,546
Ukraine				
Private sector in GDP	30	34	40	50
Privatisation revenues	0.21	0.13	0.25	0.13
Share of med-large firms privatised	12.2	12.7	53.3	72.4
Belarus				
Private sector in GDP	15	15	15	20
Privatisation revenue	0.30	0.26	0.00	0.15
Share of firms privatised	11.7	14.3	19.7	25.5

EBRD Transition Report, 1998.

In Ukraine large scale privatisation began in 1992, predominantly using managerial-employee buy outs and leasing to employees, yet eventually this method was rejected for a more ambitious plan of voucher based programme, namely the MPP in 1994. By 1997, 86% of citizens had received their vouchers and more than 45% had invested them in joint stock companies or in investment funds, assisting the creation of core investors. Additionally compensation certificates have been issued to recompense for the erosion of the value of

⁶⁰ For large scale privatisation.

⁶¹ Management employee buyout.

savings, which can also be used to buy unsold shares, or equally they can be sold to other investors.

However, despite a substantial share of medium and large firms being privatised the programme has been delayed: at the beginning of 1997, 150 enterprises had been earmarked for privatisation, but by the last quarter of 1997 only 118 enterprises had completed the process. Yet, the government's need to raise revenue for its ever increasing budget in 1998 gave rise to the implementation of cash sales for some of the largest 200 enterprises in the Ukraine. More recently the State Property Fund identified another 650 industrial companies, in which stakes could be sold (Transition Report, 2001). In the future further efforts are needed to reduce the political opposition surrounding privatisation.

Domination of insiders in privatised firms, poor financial discipline and weak bankruptcy law have slowed the pace of industrial restructuring. By mid 1998 inter enterprise arrears amounted to a staggering 80% of GDP and barter trade accounted for 42% of industrial sales. Paired with complex bankruptcy law it is not surprising that foreign investors have been repelled so far by a weak corporate governance and a poor financial and regulatory environment.

The Belarussian privatisation programme began in 1993 with the intention of privatising 8,500 republican and communal enterprises by 2000, however by the beginning of 1997 only 2,122 enterprises had been *partially* privatised - just 24% of their target. This appears to be an annual trend. The transfer of ownership has passed from the state to mainly management and employees, largely bypassing private investors.

The main method for privatisation was to convert the SOE's into joint stock companies, with 1% being sold at auctions, and as a result the state has maintained a majority ownership or a "golden share" in 33% of cases. Furthermore, joint stock companies have been created but in 1997 90 companies had not undergone any kind of privatisation.

The Belarussian programme seems to be plagued with problems, in March 1998 a presidential decree gave local authorities the right to privatise and restructure local companies, removing the requirement of parliamentary approval for the privatisation of every firm. Nevertheless, another presidential decree in June 1998 ordered the re-nationalisation

of a large department store in Minsk, and prohibited the privatisation of 2 other department stores.

This stop-go attitude has obviously serious implications for corporate governance and restructuring. In May 2001, the government adopted a five year economic development plan, which outlined that the state would still play a dominant role in the economy, however the government is planning to restart the privatisation process for small and medium firms. According to the EBRD (1997) over a half of enterprises are loss making, yet virtually none of them have been declared bankrupt, additionally the government still provides indirect subsidies to “selected enterprises” via tax concessions, import duty exemptions and directed credits. This reduces the urgency for restructuring quite substantially. Despite the share of loss making firms declining to 20% in 1998 the main cause of this is a growth in state subsidies and inter enterprise arrears, the former reaching 40% of GDP in 1997.

Surprisingly, the government appears to be encouraging joint ventures with foreign partners such as Ford Motor company, hopefully providing much needed capital and expertise for restructuring and inducing an inflow of other foreign investors⁶². This influx may soon be hampered by a decree instilling uncertainty in the investment climate by annulling tax and customs privileges to foreign investors, coupled with an erratic macroeconomy it is unlikely that there will be a constant stream of foreign investors interested in international joint ventures.

For a discussion on privatisation policies in other former communist countries, particularly on how country characteristics affect policy and in turn firm strategy see De Castro and Uhlenbruck (1997).

By examining the outcomes of the privatisation programmes in Russia, Ukraine and Belarus one common thread is clear: an aversion to outside or private investors. This is shown below in the table examining ownership trends for this sample in Russia, Ukraine and Belarus from 1994-6, while there has been some increase in the average percentage of voting shares of private external individual and foreign owners, this has been very small, particularly in Russia. What is striking is that both Russia and Ukraine have experienced an increase in managerial ownership, this may represent an effort on the managerial staff to prevent outside

ownership. In Russia this has been at the expense of private external individual ownership, however there is the question: just how external is this type of ownership? Do managers invite their friends from other companies or relatives to buy shares, or more generally those members of society who do not have any incentive to monitor managerial behaviour. Another surprising feature of this sample is that Belarus has the highest average percent of voting shares of foreigners, this may appear strange given Belarus' political stance. See chapter five for more details of the ownership structure in this sample.

Table 6: Average percentage of voting shares; 1995-7.

	1994	1996
Russia		
Manager	11.5	15.36
Total employee	55.34	52.97
Government	8.38	6.02
Foreign	0.28	0.89
Private individual	11.33	12.37
Belarus		
Manager	11.06	10.96
Total employee	61.06	57.56
Government	27.74	22.60
Foreign	0.00	1.24
Private individual	6.47	10.42
Ukraine		
Manager	9.86	11.74
Total employee	69.59	57.27
Government	9.59	8.21
Foreign	0.87	0.76
Private individual	9.38	14.82

Source: University of Nottingham database.

2.4b TRANSFER OF OWNERSHIP: TWO MODELS

In this section two theoretical models shall be presented: the first to illustrate the problems of transferring ownership from managers and employees to outsiders, and the second to attempt to find the optimal amount of outside ownership.

A simple model based on the *resale to outsiders* is the Aghion- Blanchard model of 1996, who note that in Russia a Presidential decree enforced insider owned firms to have a

⁶² Oligopolistic reaction will be explored in the internationalisation section.

majority of outsiders on their board. Despite only a very few firms heeding this by 1994, 44% of firms had some outsider representation on the board, with those firms with large average outside blockholders being particularly represented on the board. Concentrated ownership apparently then has positive implications for corporate governance, when measured by board representation.

The Aghion and Blanchard model illustrates how the transfer of insider ownership to outsiders can be problematic (although a full treatment of the model shall not be given here): the following results are found.

- the initial privatisation programme should minimise the chance of workers colluding and encourage anonymous trading.
- management ownership maybe sub-optimal as compared to employee ownership, which will depend on the probability of the management team remaining employed and his relevant human capital level.
- the social safety net for workers should be developed and labour and housing markets made more flexible to reduce the cost of being unemployed for workers. In short the reservation wage, R should be increased to ease the transfer of ownership to outsiders. This could become an increasingly troubling problem for the counties of this study as gross involuntary dismissals as a percentage of the productive employees, in this sample is 8.3, 7.2, 9.4% for Belarus, Russia and Ukraine respectively.

The model illustrates the problems of resale to outsiders in three different situations: when the firm is employee owned and workers act non co-operatively, when workers collude and finally when the firm is majority owned by a manager.

Following Aghion and Blanchard's assumptions we have:

A firm initially has n workers whose productivity without restructuring is x , when restructuring occurs productivity will be y , where $y > x$.

It is assumed that restructuring will require new capital and expertise, which only an outsider can bring, providing he becomes the dominant equity holder.

Restructuring will also involve "reactive activities" such as labour shedding, involving laying off a fraction, λ of workers (it is assumed that $\lambda = 1$).

R will represent the reservation wage of workers or the wage equivalent of being unemployed and w will be the post restructuring wage, by making efficiency wage assumptions we have $w > R$. For workers the cost of being unemployed will be $C = w - R$.

1. Outcome of resale when workers do not collude

In the transition economies, especially Russia the free rider effect may have less of an impact due to liquidity problems, with almost 40%⁶³ of the Russian population being in poverty (41% and 23% respectively for Ukraine and Belarus), it can be expected that workers will sell at less than the minimum price. When the scale of poverty and liquidity tightness is accounted for it is probable that *transfer of ownership to outsiders will not be problematic when workers do not collude*.

Why then, has the transfer of ownership to outsiders been hampered? It is due to the ability of managers to coerce workers into not selling shares, by implementing non anonymous trading measures and by actively seeking to purchase workers' shares for themselves⁶⁴.

2. Outcome of resale when workers collude.

When worker shareholders collude we can expect resale to be less likely. *Resale will only occur if $q^b \geq q^s \leftrightarrow y - x \geq w - R = c$* , where q^b is profit per share and q^s will be the minimum price at which each worker is willing to sell his share.

When assuming that it is worker shareholders involved in the resale of shares to outsiders it must be noted that they will always take into account that they will become unemployed if the firm is sold, so they will demand compensation. In short, if c the cost of being unemployed, is greater than the surplus generated by restructuring ($y - x$) no resale will occur. However, the Aghion and Blanchard model assumes perfect knowledge when it is more likely that there is a situation of asymmetric information: it is unlikely that the worker shareholder will know his exact probability of keeping his job or not, this will obviously figure in his decision whether to sell or not. Additionally, worker incentives could work in two ways: if a worker fears unemployment he may increase labour productivity to reduce the probability of being made unemployed, or he may become discouraged and lose all interest and thus decrease x . This in turn, could effect the outsiders decision to buy in the first place.

⁶³ UNDP (1997) figure with poverty being defined as \$4 PPP.

⁶⁴ Blasi *et al.* (1997) and Filatotchev *et al.* (1999).

Thus the greater the probability of being made unemployed, λ and the greater the cost of being unemployed, c the less likely resale to outsiders becomes.

3. Manager ownership

Here assume that the manager has the dominant ownership share, so that he holds a majority, $m > n/2$, resulting from insider privatisation. Dominant managerial ownership is particularly relevant to this sample, with Russia experiencing an increase in average managerial ownership of almost 4%, whereby Russian managers have seen the biggest ownership increase as compared to other ownership types. The situation in Ukraine is somewhat similar as managerial ownership has increased by nearly 2%. The probability that he remains as manager after resale is equal to π , which will depend on his relevant skills, experience, and age etc. The probability of a manager remaining in his post does not look particularly high in Russia or Belarus, where the percentage of firms that has had a manager replaced is 50 and 40% respectively⁶⁵. If B are the manager's benefits of control then resale will occur when $m(y-x) \geq \frac{\pi B}{m}$, compared to the resale condition under workers behaving collusively the following conclusions have been arrived at:

- if the probability of managers losing control is not very high then resale will be facilitated. Also if he owns all shares this makes resale even easier- due to the scale effect of managers needing to be compensated less per share.
- However, there maybe reasons to believe that π is high (in the pooled sample 44% of firms have experienced a change in management) signalling effects of being laid off will increase the benefits of being in control, B . If B and π are quite high, resale will be unlikely. This sample gives evidence of B , benefits of being in control being high, with 66.2% of managers admitting to blocking domestic outsiders. To build on the model it would be illuminating to quantify π and λ , using personal characteristics of age, experience, political leanings etc.

Despite the success of the Russian privatisation programme it seems that it did not, in some respects account for conclusions illustrated in the model: from the outset outsiders were disfavoured, managers, in some cases, have managed to buy shares from employees to

⁶⁵ The percentage for Ukraine is somewhat lower at 35%.

increase the concentration of their ownership, (in the data set here for all three countries as a whole, 19% of managers have bought shares from employees and 31% intend to in the future⁶⁶), and as yet there is little evidence of a comprehensive social safety net being built. Social support, particularly health, child care and housing are still provided by the enterprise, yet these are now in decline. This decline has not been met by an improvement in unemployment benefits from the state, the table below provides a comparison of the benefits level in other transition economies.

Table 7: Social services provided by enterprises in 1993.⁶⁷

	April	August	December
Subsidised meals	14	9	9
Subsidised goods	21	13	20
Training/education	6	4	4
Income support	14	12	11

Source: VCIOM Survey of the Working population (1993)

Table 8: Unemployment Benefits in selected transition economies

	Current law	Qualifying conditions	Benefit level	Duration
Bulgaria	1989	6 months employment in last year	60% of average earnings: 90-140% of MW ⁶⁸	6-12 months
Czech Republic	1992	12 mnth of employment in last 3 years	50-60% earnings.	6 months
Poland	1994	180 days in employment in last year	36% average national earnings	12-24 months
Belarus	1993	-	50-70% of earnings	26 weeks
Russia	1994	employment of 12 weeks in last year	45-75% average wage in past year	1-2 years
Ukraine	1992	no other income exceeding MW	50-75% average wage in previous job	12 months

World Employment Outlook (WEO), 1996/7.

⁶⁶ The figure for Russian managers is higher- 30.1% have bought shares and 28.7% plan to.

⁶⁷ % of surveyed individuals who received these services.

Although, federal expenditure on social policy has increased overall, but this may not be enough to prevent the social hardship caused by open unemployment. The table below shows government expenditure for the countries of our study.

Table 9 :Federal expenditure for Russia, Ukraine and Belarus in 1997, in % of GDP.

	Expenditure
Russia	40.4
Ukraine	44
Belarus	42.1

Source: WEO (1998) p98-99, table 17-19.

However expenditure on pensions in Russia has decreased and the fixed real monthly pension size in 1998 was only 95% of the figure for 1997. The table below shows that Russia does not compare favourably to Belarus and Ukraine when examining expenditure for pensions.

Table 10: Public pension expenditure in Russia, Ukraine and Belarus, in 1996 as % of GDP.

	Pension expenditure
Russia	4.5
Ukraine	8.7
Belarus	8.4

Source: WEO (1998), p115, box 10.

Boycko (1996) acknowledges that privatisation also involves shifting the supply of capital from public to private means. This would remove the state from the role of allocating capital, subsidies and cheap credit. By inducing firms to look for outside sources of finance this will also create a corporate governance system where outsiders' interests must be accounted for, so that decisions are made which benefit shareholders, not entrenched managers. Eventually, insider owned firms will start to feel the effects of cuts in cheap credits and subsidies initiated first by the Chernomyrdin government in 1993-4 in his stabilisation plan (see the table below for details of credit and budgetary subsidies to enterprises as a percentage of GDP) created a "push" factor for enterprises to seek outside capital. If enterprises are to survive in the long run (assuming government subsidies will decline further) they must restructure, which will demand new capital investment, with political sources of capital being reduced, insiders must look for private sources of capital.

⁶⁸ MW= national minimum wage.

Table 11: Credit to enterprises 1994-7

	1994	1995	1996	1997
Belarus				
Budgetary subsidies ⁶⁹	6.3	3.4	2.9	1.3
Credit to enterprises ⁷⁰	16.5	5.5	10.9	11.7
Russia				
Budgetary subsidies	NA	NA	6.2	6.4
Credit to enterprises	12.1	8.5	7.2	8.7
Ukraine				
Budgetary subsidies	na	na	na	na
Credit to enterprises	11.9	6.7	6.1	6.0

EBRD, 1998.

Chernomyrdin's stabilisation plan excited various methods of private capital allocation: firstly investment tenders were used where firms received core investors for equity stakes of up to 15-20%, attracting foreign and domestic outsider investors. One problem with this method is that managers fear core outsiders (as hinted above, core investors will have power to begin monitoring managerial behaviour and possibly even bring about accelerated managerial turnover) as a result managers will do everything in their power to prevent equity being acquired by these investors.

Managers seem to appear to favour issuing new equity to *dispersed* investors who pose much less of a threat. As Boycko *et al.* (1997) note the issue of new equity has led to many invaluable reforms as potential investors require an enforceable contract, which assists the birth of a system of property rights, also they require the disclosure of information, a transparent share register and easy access to stock trading. In the longer term investors will demand a solid legal and regulatory structure to govern the market for private sectors to protect their investment.

⁶⁹ As a % of GDP⁷⁰ Ibid.

Another method for enterprises to raise capital is via the banking sector, but as Boycko *et al.* claim that “Russian banks have not been a major force in providing private capital to firms,” for example, in the sample here, the average percentage of voting shares held by banks was 1.3% for all the three countries pooled, in 1996⁷¹.

As it has somewhat been briefly shown that the development of the private capital markets induces further reforms, assist restructuring and boost the creation of a corporate governance system, it would be useful to know how insiders choose their optimal level of outside financing. For this, we turn again to the seminal work of Jensen and Meckling (1976).

Their model makes the explicit assumption that the original owner has enough wealth to finance an investment function alone, but decides that he can increase his welfare by selling off part of the firm for equity, to minimise the risk of the investment. Obviously, this will not be the case in transition economies: it is unlikely that insiders will have enough capital to finance restructuring projects alone, for reasons discussed above, so they will be forced to issue equity.

The total wealth reduction insiders can expect is denoted by the agency cost function: $A_T(E^*, K; V^*)$, where E represents the manager’s incentives to exploit outsider holders of equity, V denotes the scale of the firm and K is the fraction of firm financed by outsiders. This function will be S shaped as total agency costs for a given scale of firm increase at an increasing rate at low levels of outside financing, and at decreasing rates for high levels of outsider ownership, as outsiders can impose higher monitoring constraints on insiders’ actions.

Equation 1 shows marginal agency costs as a function of K , the fraction of the firm financed by outside investment, assuming that the scale of the firm is fixed (in transition this assumption may have to be relaxed, as investment projects for restructuring may involve downsizing of the plant or labour force).

Thus we have:

$$(1) \quad \frac{\partial}{\partial K} A(E^*, K; V^*)$$

⁷¹ For Russia alone, average percentage of voting shares held by banks in 1996 was 1.96%.

Jensen and Meckling develop a diagrammatic treatment of this⁷². The vertical axis represents marginal agency cost and the marginal value of having equity financing (A), while the horizontal axis represents the fraction of firm financed by outside claims (K).

The demand curve of the owner- management for outside financing represents the marginal value of increased diversification (possibly not a major issue in the Russian case) which the insiders obtain by reducing his ownership claims and crating a diversified portfolio. It can be measured by the amount he would pay to be allowed to reduce his ownership claims in order to minimise risk of the investment/ restructuring project.

The intersection of the demand curve and the marginal agency curve will then decide the optimal fraction of the firm to beheld by outsiders, this in turn depicts the agency costs to be borne by the owner. This represents a Pareto optimal situation.

Filatotchev and Mickiewicz (2001) also examine ownership structure and its impact upon the firm, yet within a transition context. They state the importance of the institutional and legal environment, and that subsequent performance is conditional on these factors⁷³.

It would be premature to attempt to quantify the optimal level of outside ownership at this stage in transition of Russia, Ukraine and Belarus, what is more important is to encourage insiders to consider widespread outside financing, and stop firms which Chubais claims that are suffering from “inertia”. These firms seek to lobby local governments for subsidies instead of endeavouring to attract outside capital.

Developing channels of product market competition will induce firms to restructure and seek private capital sources. By liberalising trade and allowing new entrants into previously monopolistic markets, firms will be subjected to intense competition via imports on their domestic market. Exports will affect competitive pressures indirectly, by offering foreign markets as opposed to domestic declining markets, firms will have to improve on price, product quality and design to compete abroad.

While both theoretical models offer interesting insights into the transfer of ownership neither deal with transition specific corporate governance issues such as the protection of minority shareholder rights, this is an area for further research. However it was decided to include

⁷² See figure 8 in their paper.

⁷³ See chapter five for more details of their research on this matter.

them in this review as they offer interesting theoretical, as opposed to empirical, insights concerning the transfer of ownership, and the problems associated with this.

The impact of ownership on the degree of internationalisation will be a key point in this study, and will be explored in greater depth in chapter five when determining a firm's export intensity and propensity.

Having reviewed a substantial amount of literature concerning ownership and internationalisation we will now move on to the methodology chapter, which will describe how the hypotheses will be tested.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 SURVEY DESCRIPTION

Having carried out secondary data analysis (SDA) on the dataset I was not present at the questionnaire design and interview stage, therefore I have included a description of the survey design and implementation taken from existing work by the research team at the University of Nottingham. The choice of SDA brings with it many advantages (such as time and cost saving), but most importantly as Hyman states “*SDA can assist in enlarging theory,*” (1972, p23-4).

Since no list of privatised companies exists on a national level in Russia, Ukraine or Belarus it becomes impossible to acquire a stratified sample, which requires prior knowledge of the population¹. Therefore it was decided to seek a random sample of privatised industrial companies in each of the countries. Alan and Skinner (1991) document other sampling strategies such as the cluster sample, where a random sample is taken from selected groups, or a quota sample, where the interviewer is required to achieve a specific number of complete questionnaires.

Thus the aim of the Russian survey was to collect a sample of medium and large sized industrial firms, spanning the main industrial regions and branches. As for Ukraine and Belarus the aim was to collect data from firms which vary in terms of size, industry and region.

Buck *et al.*, (1999) state that it is “*difficult to evaluate the representative nature of these samples*” (p464) without data on the population of privatised firms. However the ownership distribution in the Russian sample is similar to those reported in other research studies (see below).

¹ Moder and Kalton (1975) document that stratification is a common method for obtaining a precise sample design. The procedure is carried out by dividing the population into a number of strata, such as age, sex, and then taking a random sample from each strata. A common design involves the use of a uniform sampling fraction for each stratum-*proportionate stratified sampling*. Alternatively one may adopt a *disproportionate stratified sample*, where the sample size from the stratum is proportional to the population size of the stratum. (p85).

Table 1: Ownership structure in Russia, various samples

Average shareholdings %	Higher school of Economics (1998)	NOTTINGHAM UNIVERSITY (1997)	Blasi <i>et al.</i> , (1996)
Inside shareholders	42.1	54.8	58.0
Managers	11.0	12.1	18.0
Workers	31.1	42.7	40.0
Outside shareholders	47.3	36.1	32.1
Individuals	18.6	11.2	6.0
Other enterprises	13.9	13.3	15.3
Commercial banks	1.3	1.8	1.6
Investment funds, holding companies	9.8	8.3	7.6
Foreign investors	3.7	1.5	1.6
State	8.4	9.1	9.0
Other	2.2	-	0.9

Source: Filatotchev *et al.*, (2001)

Yet, concerning firm size the sampled firms are generally larger than average, as the sample does not include start ups, as the focus here was on the main privatisation programme, excluding both start ups and tender privatisation.

Table 2: employment distribution %

Number of employees	Share of total Russian industrial employment (1995)	Share of total 1997 REB sample industrial employment
less than 200	11	6
200-499	13	24
500>	76	70
Total	100	100

Source: Aukutsionek *et al.*, 1998, taken from estimates from *Rossiiskii Statisticheski Ezhegodnik*, Moscow, Goskomstat, 1996, p497.

As for Ukraine the ownership structure is similar to that documented by Estrin *et al.*, (1998). The Belarussian sample is also rather representative as it covers 32% of all privatised firms in that country (see Buck *et al.*, 1999, p466).

Concerning industrial distribution, in Russian and Ukrainian samples the food sector is over represented, while firms in the metallurgy and chemical sectors are under represented, as they featured strongly in the privatisation programme (Filatotchev *et al.*, 2001b).

Table 3: industrial structure (excluding fuel and energy industries)

Industry	Share of total Russian industrial firms employment	Share of total 1997 REB sampled firms employment
Metallurgy	11	4.4
Chemical and petrochemical	7.1	3.5
Engineering	41.5	34.2
Timber, forestry, pulp and paper	10.5	7.9
Building materials	7.4	16.7
Glass, porcelain and glazed pottery	0	0
Light industries	10.6	14
Food	11.9	19.3
Total	100	100

Source: adapted from Aukutsionek *et al.*, 1998, *Promyshlennost' Rossii* (Moscow, Goskomsta, 1996.)

The surveys were carried out by bodies which had in depth knowledge of local conditions and networks. Surveys were carried out by the Russian Economic Barometer, The Ukrainian Free Economic Foundation and The Belarussian Institute of Social and Economic Political Studies.

The Pilot Study

In the first instance a pilot study was undertaken in order to identify if the questionnaire could be easily understood. Moser and Kalton (1975) recommend that a pilot study be undertaken in order to provide guidance on the adequacy of the sample frame, variability within the population to be estimated, the non response rate to be expected and the suitability of the data collection method. Furthermore, Allan and Skinner (1991) recommend a pilot study when research is to be based on large scale use of a structured questionnaire (p170).

Following this the questionnaire could be modified and the final survey be administered.

The main aim of the pilot study was to reduce the level of response error². Results from the pilot study revealed that the questionnaire was relatively easily understood by Russian managers, so it was decided that the survey could be carried out successfully by mail³.

Advantages of mail surveys are their cost effectiveness, easy coverage of wide geographic areas, and ease at which respondents can complete the survey. However Allan and Skinner (1991) note that although mail surveys reduce interviewer bias there is no guarantee that the respondent will complete the questionnaire.

During the pilot study managers in Belarus and Ukraine appeared to be unsure of western terminology, therefore face to face interviews were used. The main advantage of this technique is that the interviewer can ensure that the respondent fully understands the question and prompt where necessary (Allan and Skinner, 1991, p227). However the risk of interviewer bias is higher, as is the cost.

See Curran and Blackburn (2001) for other survey techniques such as the CATI (telephone interview) approach.

Questionnaire design and content

Following the pilot study the same questionnaire (which had been translated from English into Russian) was undertaken in all three countries, which included structured⁴ and closed end questions. The first set of questions related to numerically measurable company characteristics, such as investment, exports and employment.

Secondly the questionnaire sought to measure strategic intent and managerial attitudes, whereby responses are based upon a seven Likert point scale, which ranges from 1 (unimportant) to 7 (most important). Moser and Kalton (1975) note that the Likert scale is a useful tool for indicating various strengths of agreement and disagreement, when non neutral questions are to be asked. The application of these scales does raise some serious questions

² Response error occurs when a respondent misunderstands a question, which leads to missing cells.

³ Cavusgil (in Czinkota and Tesar, 1982) and Dosoglu-Guner (2001) also uses a mail survey in their study of exporting firms.

⁴ For business research it is considered that structured questions are superior to "unstructured questions", which can lead to unclear, unclassified responses (Curran and Blackburn, 2001, p73).

concerning validity and reliability of answers⁵. For these reasons two senior members of the research team randomly selected 5% of the companies and visited them to check that no deviations existed in the collected data and company records, confirming inter rater reliability.

The surveys.

The first survey was carried out in 1997 and reported firm performance, strategy, equity distribution and board structure. The survey also attempted to capture data from 1994-1996, which hoped to account for some post privatisation adjustment, but this may have created some recall loss (where respondents fail to recall information). Finally 105 responses were collected from Russia, 68 from Belarus and 100 from Ukraine.

The second survey was launched in April-June 1998, the same respondents were approached from the first survey, but several had become bankrupt, merged or simply refused, thus some new firms were contacted⁶. Nevertheless a test of non response bias was made between the second round of respondents and non respondents on variables, such as ownership structure, firm size etc., which indicated no significant difference (see Filatotchev *et al.*, 2001b).

This survey produced a longitudinal dataset of 229 firms, which was used as the pooled dataset, for 1994-6 and 1998.

3.2 EMPIRICAL STRATEGY

The survey design facilitated a quantitative approach, using positivism as a rationale for research (see Stiglitz and Driffill, 2001), rather than a normative framework.

Allan and Skinner (1991) document that statistical analysis with large scale surveys reduces many of the problems associated with smaller surveys. For example with a small survey it is difficult to disentangle the effects of various factors with confidence (p269). Large scale

⁵ However Moser and Kalton (1975) note that the Likert scale is more reliable than the Thurstone scale (an interval scale of measurement), p361.

⁶ Moser and Kalton (1975) discuss reasons for non response and state that interviewers need to decide who is "interviewable", and if substitute respondents are needed. Furthermore adjustment maybe needed for non response bias, which would require some knowledge of the non respondents, (p166).

surveys allow us to adopt statistical model building, particularly via linear regression.

However the subsequent chapters attempt to employ other statistical techniques, such as logistic regression, WLS and repeated measures analysis.

Curran and Blackburn (2001) document that positivist explanations based on quantitative or statistical techniques have become more popular, as they have become easier and quicker to implement with computer packages (such as SPSS, used in analysis here).

However it is important to note that other approaches may be adopted successfully in the social sciences or more specifically in the transition economics field. For example Curran and Blackburn (2001) state that in small business research qualitative research has become more popular over recent years: computer packages such as NUDIST or Ethnograph can be used to store and analyse qualitative data.

In the transition economy field researchers have successfully implemented a more qualitative approach by carrying out case studies. For example Yoruk (2002) has examined the importance of networks and production in several transition economies, while Djankov and Pohl (1998) have focused on the restructuring of large firms in the Slovak Republic.

Exporting research has also been carried out with case studies (see Johanson *et al.*, 1975).

3.3 DESCRIPTION AND COMPARISON OF METHODOLOGY USED IN OTHER EXPORTING PAPERS.

METHODOLOGICAL CONTRIBUTION

By describing and comparing methodological issues in other output of existing export research it will become clear that my research has succeeded in employing several techniques, whereas the majority of existing research has concentrated upon correlation analysis and linear or logistic regression. Furthermore I have merged an international business, strategy and economics approach in chapter five. By adopting an international business and strategic management approach it has been assumed that international diversification is a key role in the strategy of firms (Hitt *et al.*, 1997) and that successful internationalisation requires a change in strategy (McDougal and Oviat, 1996). In addition the learning by exporting research has also been employed from the economics literature which states that a number of performance measures are greater in exporting firms than in non exporting firms, for example productivity growth is greater in exporting firms (Delgado

et al., 2001) and exporting firms have a higher chance of survival and greater employment growth (Bernard and Jensen, 1999). By blending the three fields of literature, a greater understanding of exporting at the firm level can be gained.

Other export research that has successfully adopted a multi disciplinary approach can be found in Bhavani and Tendulkhar (2001) which amalgamates international trade theory with an industrial organisation framework.

As Bilkey (1976) notes much of previous export research has focused upon either *internal* or *external change agents*. External agents include government agencies, other firms and other market factors such as the level of industrial decline. Internal agents may be the structure and behaviour of a firm's top management. In Dosoglu-Guner's (2001) export study she notes that the failure to include industrial conditions in her analysis is a major shortcoming, which should be addressed in future research. One of the contributions of my research is to fuse internal and external change agents, by merging export determinants such as industrial decline, with firm ownership structure and size, among others factors.

Thus in similar lines to other cause and effect models (see Etgar and McConnel, 1976) we arrive at the following:

$$X = f(E,I)$$

Where X are export related behavioural decisions, E represents external change agents such as legal and economic forces, and I represents internal change agents, such as ownership structure, managerial turnover, and firm size etc.⁷

Bilkey (1976) notes that an important methodological question is whether export behaviour should be included in a multi- activity behavioural model of the firm, incorporating strategies such as increasing product lines and expanding domestic markets, or should exporting be modelled as a single activity. In line with other export research (Cavusgil, 1984, Bernard and Jensen, 1999) the model employed here shall assume a *single activity model*.

3.3B METHODOLOGY IN EXISTING EXPORT RESEARCH

MODELS EXAMINING THE IMPACT OF OWNERSHIP AND ORGANISATIONAL CHARACTERISTICS ON EXPORT BEHAVIOUR

Cavusgil (1984) represents one of the first studies to examine the impact of organisational characteristics on export behaviour. His literature review identifies the need for additional research to link internal firm characteristics with exporting activity. In his research he argues that there are four types of organisational characteristics which may influence export behaviour: sources of firm differential advantage, managerial aspirations towards export, profit and growth, managerial expectations and managerial resource allocation to exporting activity (such as market exploration or development of an export policy.)

There are two types of methodological difference between my work and that of Cavusgil. Firstly Cavusgil takes a more psychological view of internal organisational characteristics by introducing decision theory (McGuire, 1964) in order to measure aspirations. Secondly, Cavusgil uses different empirical methods such as multiple classification analysis, which can examine interrelationships between several predictors and a dependent variable, within an additive model⁷. Finally he uses Automatic Interaction Detector analysis to search for predictors which increase the power to account for variance in the dependent variable, which allows the identification of characteristics of the most passive and aggressive exporters.

Although the multiple classification analysis deals with multicollinearity and non linear terms, it only can deal with dummy variables, which mean many other continuous variables, which could affect export behaviour have had to be omitted. Furthermore AID analysis only provides us with profiles of firms operating at the extremes of export activity, and a profile is also needed for “intermediate” exporting firms. Thus it could be argued that Cavusgil should supplement his data analysis to remedy these shortcomings.

Interestingly he claims that further research should include other internal characteristics and include external determinants of exporting, my research attempts to do both.

⁷ Etgar and McConnel (1976) also include a variable which represents information processing, which was not included in my analysis, however it should be noted that no empirical test was taken on their variables.

⁸ In essence, it is similar to multiple regression, but uses dummy variables only as predictors.

More recent research by Javalgi *et al.*, (1999) empirically investigates the influence of firm characteristics upon export propensity. They include variables such as the number of employees, total sales, firm age, industrial classification and firm ownership. Several of these variables are included in my analysis, however it should be noted that Javalgi *et al.*, only use a very narrow measure of ownership, and includes a dummy variable to show whether a firm is publicly or privately owned. In contrast my analysis includes a wider range of ownership variables, and analyses the *decision to export* and *the extent of export activity*.

However they make three important criticisms of existing export research which are beneficial from a methodological point of view:

1. little has been done to document the impact of firm characteristics on export propensity across industry, i.e. inclusion of contextual factors.
2. research designs have restricted the generalisation of results
3. need for larger databases.

My research hopes to target some of these criticisms: by including industry dummies the impact of contextual factors will be considered, although using data from the fSU makes results not easily comparable. This study represents one of the first studies of exporting firms in the region (except existing research from the University of Nottingham research team). Furthermore a sample of over 200 firms is credible when considering the challenges of collecting data from such an area.

Research by Javalgi *et al.*, (1999) also attempts to correct for these criticisms by empirically investigating the impact of firm characteristics across industry type, with an enviable dataset of 20, 204 firms. However this research only includes a logistic model, whereas the analysis in chapter five, here, aims to amalgamate several empirical techniques. Furthermore the inclusion of two independent variables representing firm size (total sales and number of employees) does not account for possible multicollinearity problems.

Bhavani and Tendulkar (2001) attempt to identify variables affecting export propensity and intensity in India. They hypothesise that the form of business organisation, firm size, wages and share of sales expenses are important determinants of both functions. This is an interesting approach as they manage to merge international trade aspects, such as wages and competitive advantage with industrial organisation theory.

Variables common to my study are firm size, and the form of business organisation, yet in their study only a dummy variable is inserted to represent if a firm is a single proprietorship. They assume that the form of business organisation reflects access to capital (p65) or the firm's ability to raise finances, which is "*the basic resource at the firm level and hence the probability of its undertaking production for exports,*" (p71).

Their techniques are empirically advanced. In order to model export propensity a tobit model is used, which is suitable for a binary choice model, and assumes a normal distribution (Greene, p814), however one criticism of this paper is that they do not include results of the appropriate statistical test to show this assumption is tenable. In order to model export intensity they employ a censored tobit model, which is suitable for analysing data when some of the observations of the dependent variable are zero (Greene, p906).

A major problem of this research is that their data is cross sectional which leads to causality problems, for example we do not know if export causes firm growth or vice versa.

Furthermore their data is restricted to textile firms in India, so their results maybe only comparable to other labour intensive industries.

Lastly, Dosoglu-Guner (2001) attempts to demonstrate that export activity is caused by behavioural attributes, as opposed to financial determinants by examining the impact of organisational culture and ownership on export *intention* of US firms, which she notes is under researched.

Her framework is multi disciplinary and assumes that organisational culture affects corporate behaviour and strategy, therefore we can expect organisational culture to impact on exporting, if we consider international expansion as a part of corporate culture (p74).

She employs the usual firm variables such as firms size, but also variables on organisational culture⁹ which are constructed from questions based on a Likert scale, concerning organisation type, leadership practices etc. In addition she includes dummy variables to represent if a firm is controlled by the owner, insiders or externally controlled.

Dosoglu- Guner then uses logistic regression to model export intention, following factor analysis to assess the construct validity of the multi item scales.

The main limits of this study is the use of a very subjective dependent variable- export intention, a firm which is "interested in exporting" may have no actual intention of exporting,

thus it may have been more sensible to adhere to typical measures of export behaviour.

Finally, a criticism common to many export studies is the cross sectional data analysis, which fails to account for time lags, is a major shortcoming, however this may be compensated by the innovative measurement of organisational culture.

GENERAL EXPORT MODELS

A literature search of the strategy, economics and international business fields identified several papers analysing determinants of export behaviour¹⁰, thus the methodological aspects of papers which specifically determine either export intensity or propensity shall be discussed.

Working in chronological order we begin with a study by Andersen, although undertaken in 1993, it critically analyses some of the seminal works on exporting in the mid 1970's.

Firstly he notes that the internationalisation process has been subject to widespread empirical research, yet theoretical and methodological problems remain.

Andersen critically examined the Uppsala internationalisation model accredited to Johanson and Wiedersheim-Paul (1975) based upon four case studies of Swedish firms, which assumes that firms develop according to a chain of establishment:

1. No exporting activities
2. Exporting via agents
3. Establishment of an overseas sales subsidiary
4. Overseas production/manufacturing

The model hypothesises that firms enter new export markets with successively greater psychic distance, and emphasises the incremental and experiential nature of firms committing resources to export markets. In short the model explains internationalisation as a process of increasing experiential knowledge¹¹. Meyer and Skak (2002) also highlight the importance of experiential knowledge in international entry, which they define as expertise in cross cultural management, leadership and foreign business cultures (p180). However Andersen criticises this model as firms may not always export markets on a step by step basis (e.g. a

⁹ Namely market, adhocracy, hierarchy and clan culture.

¹⁰ Several were discarded as they discussed other elements of internationalisation, such as the perceived costs of exporting (Eriksson, 1997) or exporters performance (Domiguez and Sequiera, 1992)

firm with large resources may jump some stages in the chain), also in times of stable market conditions market knowledge can be gained from other sources than experience.

More importantly, no initial conditions are presented and the model does not explain why the internationalisation process starts as Johanson and Wiedersheim-Paul (1975) expect that *“the internationalisation process once started will tend to proceed regardless of whether strategic decisions are taken in that direction or not,”* (p12), which appears to be a strange assumption.

Andersen lastly criticises the cross sectional nature of the studies, which does not allow us to examine how and when a firm moves from one stage to the next, thus longitudinal data would be desirable. Bilkey (1976) also notes similar phenomena in earlier export research by Etgar and McConnel (1976) who limit their research to static models

In conclusion Andersen makes the following recommendations for further research in the field:

1. incorporate assumption that decision maker is strategically conscious
2. introduce a time dimension, e.g. longitudinal data analysis.

My research attempts to adhere to these recommendations by attempting to examine *why* a firm begins the exporting process (a strategy to improve performance), and assumes that a decision maker selects exporting as a strategy for this reason. Also my study does allow for a time dimension, with time lags in regression models. This is particularly important owing to the possible endogeneity of ownership, therefore lagged ownership variables are used so that the dependent variable has no feedback effect upon ownership factors¹². Of course it is accepted that a one period lag may not be sufficient in some cases, especially where the sample is relatively small. One method of testing for endogeneity would be to use a Granger causality test (see Greene, 2000, p657).

The table below compares my exporting research with that of the Upssala school, based on Andersen's criterion.

¹¹ This reduces the risk involved in going abroad and also provides a vehicle for acquiring knowledge of internal and external resources.

Table 4: A summary of the evaluation based on explanatory criteria

	Uppsala Model	My research
Aspects evaluated Type of scientific explanation	Genetic (historicist)	Non historicist(not based on a prior state)
Boundary assumption Space	No restriction	Privatised manufacturing firms in the fSU
Time	Unbounded	Mid 1990's
Causality Model type	causal cycle	Corporate governance impact on exporting, many variables- firm characteristics
Explanatory variables	only one	
Utility-scientific Assumption about firm behaviour	incremental decision making, little influence from market factors	explains why firms export does allow for the impact of market forces (e.g. industrial decline)
Variable definition	no operational definition	clearly defined
Utility-intuitive	useful for government, management	useful for export promotion, export profiles

Source: adapted from Andersen (1993) and author's own comments.

Clearly, my research meets many of Andersens' research criteria: variables are clearly defined, analysis involves more than one explanatory variable and is scientifically and intuitively useful.

Research in the 1980's was somewhat dominated by Ursic and Czinkota (1984). Their study of 182 small and medium firms in the US. They propose that the experience curve is the major factor explaining export activities¹³, by using age as a proxy for experience they then split the firms into two groups: old and young. Following this, t-tests were undertaken on attitudes towards exporting, levels of export intensity and growth in order to determine differences between the two types of firm.

Limitations of this study are twofold: while t-tests are useful for exploratory data analysis they do not determine the direct impact of age on the level of export intensity, also by using age as a proxy for experience may lead to bias, for example, some young "inexperienced"

¹² See Demsetz and Villalonga (2001) for the debate on the endogeneity of ownership.

firms may be taken over or merged with old experienced firms, which would give the young firm an experience advantage.

Next in 1996, Douglas analysed the determinants of exporting in Peruvian small and medium firms, by concentrating upon the impact of firm characteristics and marketing strategies.

In common with many other studies she uses firm size as a determinant and strategies towards diversification, however she also uses an innovative variable, perhaps seen only in export studies in global marketing journals; the marketing mix.

Her data analysis is mainly descriptive, as opposed to predictive and relies on correlation analysis and Mann Whitney U tests. However, the major limitations of the paper is the cross sectional data which does not allow us to examine the feedback loops between strategy and outcomes and lastly *"findings are based on a performance average, which lacks precision,"* (p41). As Douglas comments at the end of her research, analysis is needed accounting for the time factor.

Roberts and Tybout (1997) seminal study of export propensity in Colombia emphasises the hysteresis model by examining the significance of sunk costs to exporting, thus they hypothesise that prior market experience significantly affects current decisions to export (see p547 for a treatment of the theoretical discussion).

As well as start up costs, they include a wide selection of variables hypothesised to affect the decision to export, such as capital intensity, relative wages, plant age, industry and location dummies and lastly, similar to my study they include a proxy for firm ownership.

Their sample size is extensive, giving 5850 observations from 1981-1989, which they use to model the decision to export. Their principal research methods are the simulated moments method, which is suitable for panel data analysis, and in addition they account for serial correlation.

Their theoretical section and methodology can not be criticised, owing to sophisticated empirical techniques and wide application of their results.

Next, Wakelin (1998) examines the role of innovation in determining export propensity with a sample of 320 UK firms, spanning a period of five years.

¹³ A firm is said to move up the experience curve when they increase sales volume rapidly, thereby lowering costs.

She uses sound econometric techniques, namely the tobit model and the censored probit model to determine the impact of innovation, capital intensity, wage and labour cost (all scaled to reduce heteroscedasticity) on export propensity.

However, a methodological problem may exist in her measurement of innovation as she only uses a categorical variable to represent if a firm is an innovator or not¹⁴, this does not capture the scale or intensity of innovation. Furthermore, Wakelin states that some firms maybe mis-classified as an innovator, due to the timing of the survey (p834). Lastly although missing data appears to be a problem, there is no evidence of an attempt to solve the problem.

Samiee and Walters (1999) examine the relationship between acquired structural export knowledge¹⁵ and export intensity in 160 US firms. They measure the firms level of interest in structural export knowledge on a five point Likert scale (although it could be argued that this is not as accurate as obtaining data on *actual* export knowledge). In addition, measures were made to quantify a firm's commitment to exporting by determining whether a firm possesses an export department, or deals with exporting on an ad hoc basis (p388).

Interestingly, they use two measures of export behaviour: export intensity, and the export transaction size¹⁶, however their analysis is limited to correlation analysis, which does not allow us to explore the causal relationship between structural export knowledge and export behaviour.

¹⁴ As firm level expenditure on R&D is only available for quoted firms in Wakelin's sample.

¹⁵ Structured export knowledge can be defined as an education programme involving "*a comprehensive, diploma level course of export training,*" (p381)

¹⁶ They hypothesise that larger export transaction size leads to greater absolute profits.

Table 5: summary of research on the impact of ownership characteristics on exporting behaviour: 1984-2001

Author	Variables	Techniques	Criticisms
Cavusgil (1984)	Sources of differential advantage Managerial aspirations, expectations and resource allocation	Multiple classification analysis AID analysis	Omits important continuous variables Concentrates on extreme export profiles only
Javalgi <i>et al.</i> , (1999)	Number of employees Total sales Industry classification ownership	Logistic regression	Uses a narrow measure of ownership Possible multicollinearity
Bhavani and Tendulkar (2001)	Business organisation Firm size Wages Sales expenses	Tobit regression Censored Tobit regression	Cross sectional dataset only Applicability of results
Dosoglu-Guner (2001)	Organisational structure Ownership Firm size	Logistic regression	Subjective dependent variable Cross sectional dataset only

Source: Author's own

3.4 METHODOLOGY USED IN CHAPTER SIX: FOREIGN PARTNER SELECTION IN THE FSU: CONSIDERATIONS AND COMPARISONS

The aim of this chapter is to account for the extent of partner presence in Russia, Ukraine and Belarus and to provide explanations for the presence or non presence of foreign partners. The following section shall describe the methods used to investigate these research questions.

The first section of the chapter is mainly descriptive and examines the extent of collaboration with foreign partners and the extent to which firms are seeking foreign partners. In addition, foreign partner perceived objectives, local firm attractiveness and perceived resource contribution are also explored. As one of the main research aims is to explore the heterogeneity of the region, non parametric tests were undertaken to see if the number of collaborations with foreign partners were the same over time and to examine whether mean scores on Likert scales were the same for all three countries.

As described in the following chapter presenting exploratory data analysis, the assumptions of normality were broken, thus non parametric tests must be used, such as the Wilcoxon Z

test and the Kruskal Wallis test. It must be noted that there are some downsides of using these tests as they may reduce the power to reject the null, should it be false (Kinnear and Gray, p163,1999). However they do not assume normality or homogeneity of variance and use measures such as the median which are not affected by outliers. Furthermore, the Wilcoxon Z test provides exact significance values calculated on the basis of the normal distribution (Field, p55, 2000).

In order to test if the number of established links were the same in 1996 and 1997 in each country and if the number of firms seeking foreign partners were the same in 1996 and 1997 the Wilcoxon Z test was employed which is based on ranks (see Field, p55, 2000). This test is suitable for related samples, as the same subjects have been measured in both years. In this test we assume that the null hypothesis (H_0) states that there is no difference between the number of established links in 1996 and 1997. If the p value of the Z statistic is greater than 0.05 we can accept the null. If the p value is less than 0.05 we reject the null, and we can say that there is a significant difference between the number of established links in 1996 and 1997.

In order to test if the mean responses were the same for each country, concerning issues such as local firm perceptions on what foreign partner are seeking, the Kruskal Wallis test was employed. This is suitable for when we have K independent samples (i.e. the subjects are not the same across the three groups).

The null hypothesis is that the means are the same across all three groups. The test gives us the chi square test statistic and its p value (asymptotic significance), if this is less than 0.01 then the Kruskal Wallis test confirms that the mean is not the same across all three countries (see Kinnear and Gray, p188, 2000).

The final part of the paper sought to explain the reasons behind a firm having a foreign partner, for this logistic regression was used, which is described below, in section 3.5.

3.4B METHODOLOGY USED IN SIMILAR RESEARCH

Several other papers have also attempted to examine issues concerning partner selection in emerging markets.

Some researchers have focused upon trans-national companies' (TNCs) strategies for entering transition economies, as opposed to the host country perceptions and objectives.

For example, Meyer and Skak (2002) examine international entry of Danish and Austrian (small and medium) firms into Russia, by using a “*multiple lens*” approach (p182) of survey data and case studies. An innovative part of their theoretical framework was their inclusion of network theory and the idea of serendipity in the internationalisation model. They hypothesise that business networks (long term business relationships) facilitate internationalisation (p180), furthermore they highlight an element of serendipity- “*fortunate and unexpected discoveries made by chance,*” (p181), such as meeting a foreign business contact at a trade fair, can assist the internationalisation process.

Their descriptive analysis shows that both Austrian and Danish firms rank personal connections very highly as a source of information on Russia (p184), and that reactive entry¹⁷ is a very common entry mode into Russia (p185).

A minor criticism of their research is the failure to account for the dynamic process of internationalisation, however this may be caused by the fact that research on serendipity is in its infancy.

In addition, Manea and Pearce (1999) surveyed 26 enterprises in Romanian manufacturing and extracting sectors, and asked TNCs to evaluate the importance of a number of factors when deciding to invest in Romania, the importance of market seeking and the importance of sources of technology, on a three or five point scale. Their main finding from their descriptive analysis was that TNCs main motives for investing in Romania was to create a market seeking subsidiary, which operates on standardised technology, leading to a limited contribution to the industrial transformation process. One of the main limitations of their research was the small sample size, caused by a low response rate of 25% and response scale design: 3 or 5 point scales allow very little variance in answers. However, their survey does manage to classify efficiently the strategies of TNCs.

Bridgewater (1999) examines the entry behaviour of multi-national companies entering Ukraine. Unlike our study of foreign partner selection she uses a multi disciplinary framework: economic based theories (oligopolistic reaction), incremental models and network theory in order to enrich the understanding of international market entry.

Similar to Manea and Pearce, Bridgewater assumes a case study approach and her analysis is mainly descriptive as opposed to using quantitative methods. For each of her four case

studies she examines firstly the firms' network relationships and then the selected market entry process. One limitation of her study is the lack of analysis of how the multinational company selects the Ukrainian partner.

Research by Banai *et al.*, (1999) takes a similar thread to ours, where the focus is on the perceptions of the *host* firm, as opposed to those of the entering firm. Their work describes managers' perceptions of *prospective* Russian-US joint ventures, provides insights into benefits and expected problems, preferred equity structure and system of managerial control.

Thus their methodological framework is much the same to the one adopted here: examining managerial expectations of international joint ventures as a background for improving the performance of potential international joint ventures. This is a relatively new perspective as most of previous research has examined the characteristics of the joint venture on performance, or examined the behavioural dimensions (such as technology) on performance. Their main research questions are why is a joint venture attractive, what problems are envisaged, what strategic decisions are important to Russian managers, what is their ideal equity structure and managerial philosophy?

To investigate these questions a survey was undertaken of Russian managers attending a training programme in the US, during the period 1992-1995. They achieved a high response rate (70.6%) and received usable responses from 226 managers. In the survey managers were asked for example, to rank their motives for entering a joint venture on a scale of 1-10 and to assess to what extent ideal US managers should act like from a wide range of scenarios.

They then adopted a quantitative approach based upon non parametric tests. The Friedman test (which is suitable for ordinal variables) was employed to compare distributions of several related variables, and test the null hypothesis that scores for each topic come from the same population (i.e. the mean scores are the same for Russian motives and the Russian perceptions of US motives.) For interval scales the Chi square was used to test the equal distribution of variables, if the null is rejected, it can be argued that means are different due to differences in the populations.

¹⁷ Reactive entry is a case where contact with foreign partner occurred by chance.

Only two criticisms can be made of the research by Banai *et al.*, firstly, the survey was undertaken in the US, which could lead to some response bias, and secondly some of the questions are based on Western theories or models, which may mean some topics are hard to understand for Russian managers. I am confident that managers surveyed by the University of Nottingham research team were able to understand the questions as the survey instrument was piloted successfully. In addition in the case of Belarus and Ukraine interviewers were on hand to check that respondents fully understood each question.

Hitt *et al.*, (2001) propose that there has been little research on how firms select partners for strategic alliances in emerging markets, they use a resource based and organisational learning framework to examine partner selection in emerging markets and the developed world. They make a number of hypotheses concerning the priorities of executives in emerging markets and in the developed world when entering a joint venture (such as the emphasis on financial assets, managerial capabilities, technological assets etc.)

To test these hypotheses they carried out telephone interviews in Canada, US and France with company executives (receiving a 23% response rate, and usable responses from 85 firms), in order to capture the priorities of executives in the developed world. In Poland, Romania and Mexico it was decided that personal contacts were needed, this brought about a response rate of 70%, providing responses from 97 firms. Interviews in all countries were carried out during the period 1995-1998.

The survey instrument included demographic questions, definitions of partner selection criterion, and also included a series of case studies, for which managers had to make decisions on, given the information presented.

The first part of their data analysis used hierarchical linear regression in order to rank criterion for foreign partner selection in developed market firms and those in emerging markets. This method is appropriate when controlling for autocorrelation, and heteroscedasticity.

Finally, Hitt *et al.*, carried out a number of t-tests in order to highlight the differences in foreign partner selection in the two market contexts.

Their main results were that emerging market firms put more emphasis on financial assets, technological capabilities, intangible assets, willingness to share expertise in selecting a foreign partner. As for developed market firms, they put more emphasis on market access and local knowledge and unique competencies.

Further research needs to focus on the fact foreign partner selection is a dynamic process, and several stages of negotiations maybe needed until an agreement is made, during this process motives and objectives may change. Furthermore, as Hitt *et al.*, claim further research needs to examine how partner selection leads to joint venture success. Our research presented in chapter six hopes to partly meet this challenge and shed light on the foreign partner selection process in the fSU.

3.5 DESCRIPTION AND RATIONALE FOR QUANTITATIVE TECHNIQUES

LINEAR REGRESION

The starting point of analysis was OLS linear regression, which has already been used widely in the exporting and transition economics literature (see Bernard and Jensen (1999), Bleaney *et al.*, (2000) and Buck *et al.*, (1999).

This improves on the research of Douglas (1996) who uses only descriptive statistics and correlation analysis in her study of exporting firms in Peru.

Greene (2000) explains that the multiple linear regression model is used “*to study the relationship between a dependent variable and several independent variables,*” (p210).

The multiple linear regression model takes the form:

$$y_i = \beta_1 x_{i1} + \beta_2 x_{i2} + \beta_k x_{ik} + \varepsilon_i$$

$$i = 1, \dots, n,$$

Where y is the dependent variable, x are the independent variables and ε_i is the disturbance term.

Subsequent econometric investigation allows us to estimate unknown parameters in the model and to test the validity of a theory in light of available data. One of the most common methods of estimating the parameters of the linear regression is used here, the least squares method; see Greene (p223, 2000) for details of the fitting criteria etc.

However the classical linear regression model relies on several assumptions, namely (Gujarati, p69, 1995):

1. The regression model is linear in the parameters
2. X's are assumed to be non stochastic
3. The disturbance term has a mean value of zero

4. Homoscedastic or equal variance of disturbance term.
5. No autocorrelation between the disturbance terms.
6. Zero covariance between the disturbance term and x_i
7. The number of observations (n) must be greater than the number of parameters to be estimated.
8. Variability in x values
9. No specification bias or error in the model
10. There is no perfect linearity.

The following chapter presents non parametric tests where it is revealed that most variables to be included in the analysis were non-normal, thus breaking assumption two of the classical regression model (independent variables are assumed to be *non stochastic*) since the variables are shown to be stochastic.

Although some of the positive statistical properties associated with the assumption of non stochastic regressors will be lost, Kmenta (1986) notes the following,

“relaxing the assumption that X is non stochastic and replacing it by the assumption that X is stochastic but independent of $[u]$ does not change the desirable properties and feasibility of least squares estimation,” (p338).

By plotting independent variables against standardised residuals we can see that this assumption is tenable.

In addition, in chapters five and six, other data analysis techniques shall be used, which either allow for or correct for diversions away from assumptions about data.

LOGISTIC REGRESSION

Firstly, logistic regression does not rely on distributional assumptions in the same sense as other techniques, yet the presence of multicollinearity can cause biased estimates and inflated standard errors.

In this manner *export propensity* shall be determined, i.e. which factors determine if a firm decides to export or not. Bhavani and Tendular (2001) in their study of Indian firms estimate both the export decision function and the export performance function (or the share of exports in total output). Chapter five shall also follow a similar pattern. Dosloglu - Guner's (2001) research has a similar theme to mine: it examines the impact of organisational culture

and ownership on export propensity or intention, by adopting logistic regression. My work improves on this by examining the impact of ownership upon export intention *and* intensity, with a wider selection of techniques.

Logistic regression is the ideal technique as it is used when an outcome variable is a dichotomous or categorical variable, such as whether a firm is an exporter or not, or whether it has a foreign partner or not. Logistic regression involves predicting the probability of the outcome variable, given known values of the explanatory variables.

As a result the logistic regression equation takes the form:

$$P(Y) = \frac{1}{1 + e^{-z}} \text{ where } z = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_n X_n + \varepsilon_i \text{ (Field, 2000)}$$

The parameters are estimated using the maximum likelihood method which chooses coefficients which make observed values most likely to have occurred.

The beta coefficients can be viewed as the impact on the odds ratio of export propensity.

For example, if the beta is positive then this indicates an increase in odds of a firm being an exporter or having a foreign partner, similarly if the beta is negative this represents a decrease in odds. Results in subsequent chapters shall also discuss the marginal effects that are elasticities evaluated at the mean.

In order to analyse the usefulness of the model we can refer to classification tables, which shows how many cases are correctly classified (in the analysis tables this is labelled “% correct”). Additionally, Hosmer and Lemeshow’s R^2 can be used to evaluate how the inclusion of the explanatory variables improves the model. It is calculated in the following manner:

$$R^2 = \text{model chi squared} / \text{original -2 log likelihood}.$$

Values can vary from 0-1, where a value of 0 represents a case where explanatory variables poorly predict the outcome variable, and where a value of 1 represents a case where explanatory variables predict perfectly the outcome variable.

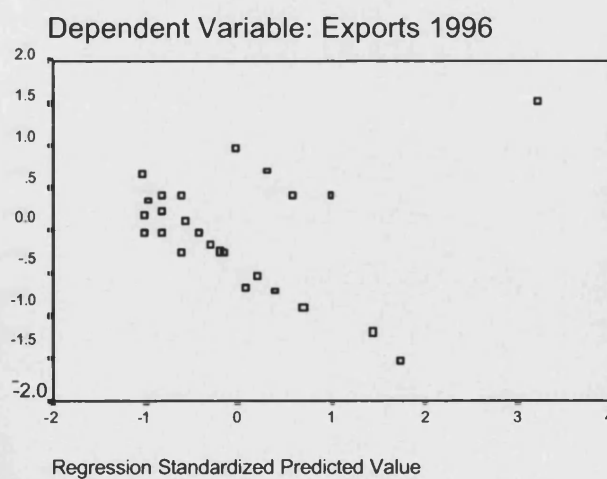
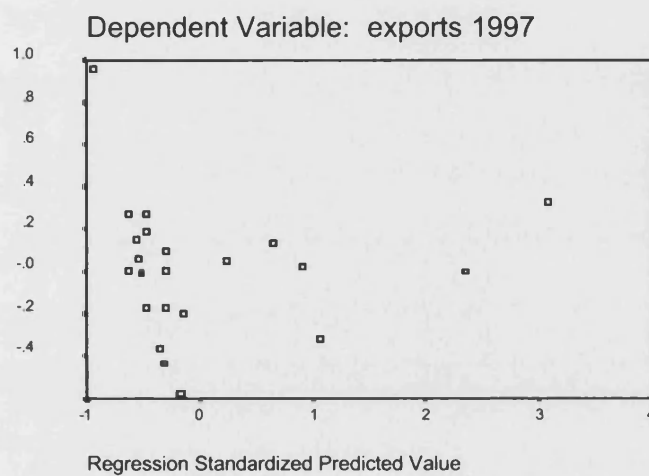
WEIGHTED LEAST SQUARES ANALYSIS- CORRECTING FOR HETEROSCEDASTICITY.

Similarly, weighted least squares regression provides optimal model estimates when variance is not constant within the population of study, compared to standard linear regression. The

weight estimation procedure can compute the coefficients of a linear regression model using WLS so that more precise observations are given greater weight in determining the regression coefficients.

The scatter-plots below show that the fourth assumption of the classical linear regression model of homoscedastic disturbances has been broken, thus

$E(u_i^2 \neq \sigma^2)$ where $i = 1, 2, \dots$ and u_i^2 represents the disturbance term which is equal to a constant σ^2 (Gujarati, 1995, p356.)



The plots of the standardised residuals against the standardised predicted values of the dependent variables in 1997, and 1996, reveal heteroscedasticity. Chapter five, table nine includes specification details and results of regression using the WLS technique.

Field (2001, p157) cites that the above plots should show a random display of dots equally dispersed around zero. Instead, the residuals appear to be clustered around -1. This makes remedial measures necessary.

Davidson and Mackinnon (1993) recommend a method called *weighted least squares* (WLS)¹⁸ which is appropriate when error terms are heteroscedastic (see Gujarati, 1987, p381, for other methods).

Therefore the following model can be estimated:

$$\frac{y_i}{\sigma_i} = \beta_1 \left(\frac{x_{0i}}{\sigma_i} \right) + \beta_2 \left(\frac{x_i}{\sigma_i} \right) + \beta_k \left(\frac{x_{ik}}{\sigma_i} \right) + \left(\frac{v_i}{\sigma_i} \right)$$

Here the GLS¹⁹ procedure minimises a weighted sum of residual squares with $1/\sigma_i^2$ acting as a weight, and σ_i is the standard deviation of exports. This technique gives more weight to precise observations, and less weight to highly variable observations. Gujarati (1987) states that these estimators are known as General Least Squares estimators and are BLUE (best, linear and unbiased).

However, Johnston and DiNardo (1997) note that unfortunately there are several disadvantages linked with this technique, σ_i^2 (or the structural form of heteroscedasticity) is rarely known, and the independent variables must be linear.

The SPSS 8.0 package allows us avoid the first problem by allocating a weight to the appropriate variable²⁰.

POOLED REGRESSION TECHNIQUES

Given that we have several time points for the dependent variable it may be useful to pool the data, where the same cross sectional unit, in this case a firm, is surveyed over a period of time (Gujarati, 2001).

¹⁸ This is a type of Generalised least squares (GLS) procedure where regressors are multiplied by weights which vary across observations.

¹⁹ Note that the terms GLS and WLS can be used interchangeably in the context of heteroscedasticity.

Baltagi (1995) lists several advantages of pooling data or using panel data techniques. For example panel data offers more variability, reduces the problems of collinearity, and provides more degrees of freedom and efficiency. In addition by surveying the same unit over time, panel data allows us to examine dynamic relationships. Since the exporting process is believed to have a dynamic dimension, panel data techniques may prove beneficial.

In the first instance the following *fixed effects* model was estimated²¹:

$$Y_{it} = \beta_1 + \beta_2 X_{2it} + \beta_3 X_{3it} + \dots \beta_n X_{nit} + u_{it} \text{ (see Gujarati, p642, 2001)}$$

Where $i = 1, 2, 3, 4 \dots 229$ and stands for the i th cross sectional unit and t denotes the t th time period. The X 's are assumed to be non stochastic and the error term has the following distribution : $E(u_{it}) \sim N(0, \sigma^2)$.

As each firm or cross sectional unit has the same number of time series observations, we have what is known as a *balanced panel*.

As results showed the time dummy variable to be highly significant and the F test revealed that the inclusion of the variable was valid, an additional regression equation was estimated using interactive slope dummies²² taking the following form.

$$Y_{it} = \alpha + \beta_1 TIME + \beta_2 X_{2t} + TIME\beta_2 X_{2t} + \dots \beta_n X_{nt} + TIME\beta_n X_{nt} + u_{it}.$$

If these slope dummies are statistically significant we can conclude that it is not advisable to pool the data and single year regressions are more suitable.

REPEATED MEASURES ANALYSIS.

Bergh (1995) highlights the benefits of adopting a repeated measures design, whereby subjects are measured two or more times for a particular dependent variable. These designs can be used to test differences in means over a certain period. In chapter four mixed repeated measure design shall be used, the *within groups design* which tests whether means vary for a group of subjects and the *between groups designs* which tests if the means change over time for two independent groups.

²⁰ The weight function = $1/(\text{weighted variable})^{\text{power}}$, the power can range from -6.5 to 7.5, and is used to compute the weights, the power which produces the best maximising log likelihood function is stated in the results section. The weighted variable is related to the variability in the dependent variable.

²¹ It should be noted that the t (number of years available) is too small to run more sophisticated dynamic panel data techniques.

²² Which are defined as the time dummy multiplied by the main ownership variables.

By using repeated measures techniques the Mauchly's sphericity test will examine the variance-covariance matrix of an orthornormalised dependent variable to ensure that the sphericity assumption holds. If the assumption is violated then an adjustment will be made to the degrees of freedom when validating the significance of the F ratio.

Bergh (1995) also warns of the dangers of not adhering to the analytical assumptions of repeated measures designs. His in depth content analysis of studies focusing upon the relationship between diversification and performance, shows that very few studies recognise the symmetry assumptions, which is otherwise known as the assumption of homogeneity of covariance between repeated assessments²³, and even fewer adopt contrasts²⁴ in order to test the differences in multiple measurement of means. Games (in Von Eye, 1990) also notes that this procedure for adjusting the degrees of freedom to compute an index of sphericity "*is one of the great neglected areas of statistical application,*"(p91), and many programmes, even journals, ignore the "epsilon factor".

Following these criticisms of previous research the Mauchly sphericity test will be used in order to test for violations in symmetry, in line with recommendations of Bergh (1995) and Keselman *et al.*, (1980), consequently epsilon modification will occur, which multiplies the degrees of freedom for the ANOVA univariate model by the epsilon value. The Greenhouse- Geiser epsilon is typically employed, where generally:

$$1/(k-1) \leq \epsilon \leq 1.0, \text{ where } k = \text{number of levels of the repeated measures factor, } J.$$

Games (1990) notes that the lower the index the further away we are from the desired condition of sphericity. However, in cases where ϵ is greater than 0.75 the Huynh- Feldt epsilon shall be used instead²⁵ (see Field, 2000, p334).

Furthermore contrasts will be used, namely the *repeated* contrast, which is particularly useful where levels of the independent variable are presented in a meaningful order. In this

²³ McCall and Appelbaum (1973) focus on solutions for cases where this assumption is violated, and state that when time is a factor, research can often not meet this criterion. They offer the Greenhouse- Geisser procedure and the MANOVA approach to combat the problems of heterogeneity of covariance.

²⁴ A contrast can be used in order to evaluate changes in three or more measures of means simultaneously, a simple contrast tells us if the difference in mean is constant over time, or a more complex contrast can test whether a difference in measurement means is non linear.

²⁵ Games (1990) argues that the Hunyh Feldt epsilon may produce type 1 errors in small samples, however the sample used here is not particularly "small."

case the independent variable is measured at successive points in time (see Field, 2000, p329).

Following these suggestions repeated measures design was carried out firstly using a *between subjects* and *within subjects design*. The between subjects factor determines whether a firm has increasing or decreasing levels of export intensity during the period 1994 to 1997, the within subjects factors, or the independent variables are observed for three points in time, 1994, 1996 and 1997.

THE PROBLEM OF MISSING DATA

Analysis was not only hindered by the fact that some of the assumptions of the classical linear regression model were broken, but also by the existence of missing data. The solution to this problem is discussed in this section

One of the most difficult estimation problem in research is that of missing data, and the selection of techniques to deal with this problem should depend on the pattern of missing data (Rovine and Delaney, in Von Eye, 1990).

Missing values in the data used here are defined as *system missing*²⁶ which occurs when a respondent does not answer a question. The SPSS package²⁷ and Rubin (1996) claim that missing data can cause several problems: firstly standard statistical methods assume complete data; units with missing data represent missing information, so overall there is a loss of information, and units with complete information are systematically different from units with incomplete data. The implications are twofold: estimation may be subject to bias and estimates will be inefficient.

Rovine and Delaney (1990) emphasise that the first step in missing data analysis should involve determining the pattern of missing data. In order to employ most statistical techniques a model is needed for the data and missing value mechanism. The missing data mechanism model may assume that the data is missing completely at random (MCAR)²⁸ or missing at random (MAR). In this case, we have repeated measures of a variable over a

²⁶ This is opposed to the case where a missing value is defined as *user defined missing*, where the researcher declares certain cases as missing if s/he does not want them included in the analysis.

²⁷ See http://www.spss.com/spss/mva/mva_example.htm

²⁸ This refers to the instance where the "missingness" of variables is not related to values or patterns of other variables in the dataset.

three year period, which complicates matters further for missing data patterns, due to drop outs from the survey (e.g. firms becoming bankrupt). However Rovine and Delaney note that again the optimal missing data pattern is MCAR, where no mechanism affects the occurrence of missing data.

In order to determine which assumption is correct for the data there are several statistical tests, for example Kim and Curry (1977) use a log linear model to test whether the incidence of missing data of one variable predicts the incidence of missing data on another variable. Given the statistical software available Little's multivariate test of MCAR was employed in my analysis, and gave the following result: a chi square statistic equal to 5059.1, significance level of 1.0. From this result we can not reject the null hypothesis that the data are missing completely at random (MCAR).

Rovine and Delaney list a number of methods for dealing with missing data, simple procedures include mean insertion, list wise deletion and likelihood estimation suitable for nested²⁹ missing data (p59). The table below presents some of the pros and cons of various methods.

Table 6: Methods of missing data estimation for longitudinal studies

Method	Assets	Liabilities	Required Pattern
Listwise deletion	consistent matrices	decimates data	MCAR
Pairwise analysis	uses all available data	can yield inconsistent matrices	MCAR
ML estimation	use of maximum amount of predictive information	not easy to compute	MAR
Mean insertion	easy to compute	depresses variance may give strange correlation/covariance matrices	MAR
Subgroup mean insertion	maintains some variance	dependent on the selection of groups and waves	MAR

Source: adapted from Rovine and Delaney, in Von Eye, 1990, p59.

However, SPSS presents a solution to the problem of missing data with the Maximum Likelihood (ML) approach.

²⁹ Missing data can be deemed to be "nested" when respondents remain missing in subsequent waves of the survey.

As we can assume that the data is MCAR the danger of biased information is reduced, yet there is still a loss in efficiency, therefore an EM algorithm method can be employed to impute missing data in order to improve the preciseness of results. The Expectation maximisation (EM) approach involves an iterative procedure, the first step is to compute the expected value of the complete data log likelihood, secondly the M (maximisation) process substitutes the expected values for the missing data and then maximises the likelihood function in order to estimate new parameter estimates. The procedure continues until convergence is met. Thus this EM procedure shall be implemented in order to impute missing values. This modified data shall be used for the regression analysis in further chapters. Rubin (1996) recommends a multiple imputation technique which is not possible with the software packages available, thus the EM procedure shall be adopted instead, which can be expected to give better results than the method of *“fill in the mean and ignore”* (p480, Rubin, 1996) which Rubin claims not to be statistically valid³⁰.

Thus the regression analysis shown in following chapters is undertaken with the dataset where missing values have been replaced by the EM procedure.

However I acknowledge potential problems with the EM technique. Some researchers have criticised it for inflating standard errors, yet with the software available there is no clear method for correction (see Allison, 2002). Despite this drawback it is still being used in several papers (see Fitzmaurice and Laird, 1997).

³⁰ An alternative to the EM procedure would be to run a Monte Carlo experiment, using a data generating process (DGP) which will involve a number of replications. This results in a new set of data being generated and calculations of estimators of test statistics. As the number of replications can reach 5000, the computer software available is unable to perform this procedure. Thus the EM process is used.

CHAPTER FOUR: DESCRIPTIVE STATISTICS AND EXPLORATORY DATA ANALYSIS

4.1 DESCRIPTIVE STATISTICS

This chapter shall deal with the descriptive statistics for the ownership, corporate governance and exporting variables used in the two data analysis chapters, five and six. Also some statistics shall be given for general firm characteristics such as employment levels, investment and industrial decline will be acting as controls. This section, along with the literature search has assisted in the development of the hypotheses presented in chapter one.

VARIABLE DESCRIPTION

Firstly the variable description for the correlation table shall be given.

BFOR = percentage of seats on the supervisory board held by foreign investors

BINS = percentage of seats on the supervisory board held by managers and employees.

BOUT = seats on the supervisory board held by banks, investment funds, private individuals, industrial companies and foreign companies.

EMPL = the percentage of voting shares held by all employees collectively.

FRGN = the percentage of voting shares held by foreign investors.

GVRT = a dummy variable equal to 1 if a firm has experienced a decline in state ownership, and zero otherwise.

INSTN = the percentage of voting shares held by institutions (the sum of trading partners, banks and investment funds).

OUT = sum of percentage of voting shares held by outsiders (the percentage of voting shares held by banks, investment funds, private individuals, industrial companies and foreigners)

INTOUT = an interaction variable consisting of board seats on supervisory board held by outsiders divided by the total number of board seats multiplied by the percentage of voting shares held by outsiders.

NEWDIR = a dummy variable equalling one if a firm has a new general director and zero otherwise.

EABR = exports to outside former CMEA as a percentage of sales.

DOMOWN = a dummy variable equalling one if a firm has a dominant owner, and zero otherwise

DOMOUT = a dummy variable equalling one if a firm has an outside dominant owner, and zero otherwise.

INVT = annual investment in million current roubles.

LOGEMP = the logarithm of the number of employees.

GD96_94 = an industry's reported decline in real output over the period 1993-1996, as a percentage of 1993.

GD95_94 = an industry's reported decline in real output over the period 1994-1996, as a percentage of 1993.

These are derived from the questionnaire show in the appendix.

Table 1: Descriptive statistics for Ownership and firm size in Russia, Ukraine and Belarus*

	All three countries pooled	Russia	Ukraine	Belarus
Ownership/board structure	% of seats held by foreigners	% of seats held by foreigners	% of seats held by foreigners	% of seats held by foreigners
1994	0(0)	0(0)	0(0)	0(0)
1996	0.2(1.8)	0.38(2.6)	0.1(0.57)	0(0)
1997	0.8(5.5)	0.004(0.03)	0.85(5.65)	1.47(7.5)
	% of seats held by insiders	% of seats held by insiders	% of seats held by insiders	% of seats held by insiders
1994	77.9(27.3)	76.15(24.88)	82.06(29.09)	76.46(29.71)
1996	74.9(28.9)	72.63(27.74)	79.54(29.72)	72.87(29.89)
1997	70.8(28.6)	70.52(29.49)	66.33(29.25)	74.87 (27.03)
	% of seats held by outsiders	% of seats held by outsiders	% of seats held by outsiders	% of seats held by outsiders
1994	12.4(20.2)	18.45	6.93(15.81)	7.37(18.65)
1996	17.7(25.3)	24.78(26.06)	12.64(23.14)	13.51(24.73)
1997	15.6(24.2)	26.98(28.66)	25.16(27.83)	13.28(21.87)
	Foreign ownership	Foreign ownership	Foreign ownership	Foreign ownership
1994	0.5(3.6)	0.39(2.44)	1.14(6.76)	0(0)
1996	0.8(5.5)	0.84(3.46)	0.75(5.44)	1.49(7.5)
1997	1.9(9.9)	0.89(4.95)	3.15(14.33)	2.57(10.75)
	Government ownership	Government ownership	Government ownership	Government ownership
1994	13.2(24.0)	5.86(12.72)	12.41(28.0)	28.04(30.24)
1996	10.2(20.9)	4.01(11.8)	10.0(22.09)	20.17(26.83)
1997	10.9(20.8)	7.56(17.44)	8.44(17.43)	18.69(26.58)
	Institutional ownership	Institutional ownership	Institutional ownership	Institutional ownership
1994	3.5(9.4)	5.88(11.62)	3.18(10.93)	1.3(3.32)
1996	8.0(15.5)	9.91(18.82)	8.7(15.85)	5.69(11.49)
1997	9.5(16.9)	10.56(18.01)	10.18(19.22)	7.16(11.98)
	Outsider ownership	Outsider ownership	Outsider ownership	Outsider ownership
1994	17.5(21.7)	21.86(22.16)	16.91(26.24)	9.32(13.0)
1996	25.1(24.6)	24.23(22.97)	30.53(27.8)	19.17(19.29)
1997	25.1(24.6)	29.46(25.55)	27.0(25.41)	21.87(20.09)
	Outsider corporate control**	Outsider corporate control**	Outsider corporate control**	Outsider corporate control**
1994	275.5(823.1)	358.49(808.73)	222.87(837.89)	181.16(842.6)
1996	761.7(1442.5)	827.87(1584.42)	593.17(1341.33)	528.28(1334.48)
1997	780.8(1527.8)	827.87(808.73)	945.44(1934.98)	493.38(969.39)
Firm size	Log employment	Log employment	Log employment	Log employment
1996	2.7(0.4)	2.56(0.49)	2.73(0.43)	2.82(0.37)
1997	6.0(1.1)	5.72(1.14)	6.04(0.97)	6.51(0.88)

* mean and standard deviation in parentheses. ** Defined as % of seats held by outsiders multiplied by % of shares owned by outsiders. For insider ownership see chapter five, table one, other descriptive statistics such as investment, managerial turnover can be found in Chapter six, section 6.5, table one.

Table 2: Frequency chart for countries pooled

As the impact of a group of dominant owners on exporting is an important element of this study, the following statistics are presented.

% of firms with:	Pooled	Russia	Ukraine	Belarus
a group of dominant owners in 1994	71.7	71.6	66.2	78.9
a group of dominant owners in 1996	71.7	71.6	66.2	78.9
a group of dominant owners in 1997	71.2	75.0	71.8	64.2
a group of dominant outsider owners in 1994	6.6	12.2	4.1	1.8
a group of dominant outsider owners in 1996	7.0	11.1	4.1	1.8
a group of dominant outsider owners in 1997	19.3	19.8	18.9	18.9
a group of dominant insider owners in 1994	63.2	62.8	59.5	68.4
a group of dominant insider owners in 1996	51.2	66.7	36.5	57.9
a group of dominant insider owners in 1997	57.6	56.5	52.8	64.2
a new director in 1996	27.2	27.1	26.8	10.5
a new director in 1997	19.1	14.1	32.4	28.1

Table 3: Evolution of export intensity¹ (standard deviation in parentheses), %.

	Export intensity 1994	export intensity 1996	export intensity 1997
Countries pooled	4.2(13.3)	6.4(17.1)	6.0(17.8)
Russia	2.1(7.5)	3.4(9.5)	4.0(14.3)
Belarus	8.8 (21.0)	10.8(23.6)	7.8(18.1)
Ukraine	3.3(10.3)	6.6(17.3)	6.2(19.2)

Tables one to three suggests several findings about the evolution of ownership structure and export intensity during the period 1994-1997.

Firstly if we look at insider ownership and control, this has fallen over the period 1994-7 in terms of percentages of voting shares and board representation. In contrast outside ownership has increased in terms of percentage of voting shares, however there seems to be a discrepancy between outside ownership and outsider board representation, as the latter has experienced only a very small increase.

Foreign ownership has also increased, albeit very slightly to 1.9%. This level of foreign ownership can be deemed as “*low penetration of foreign capital* (less than 6%)” by Molero (2001), who finds that different levels of foreign ownership can be expected to have different effects upon economic variables such as technical complexity, employment levels

¹ Export intensity is defined by exports/total sales.

and the specialisation index. Blömstrom and Sjöholm (1999) find differing results for Indonesian firms: plants with high *and* low levels of foreign ownership still positively affect labour productivity. Results from chapter five show that foreign ownership affects exporting, reflecting that even low levels of foreign ownership will affect exports in different manners. Institutional ownership has increased by 5.2% over the period 1994-7, suggesting that managers are becoming more open to outside ownership or that they are beginning to sell their shares in order to restructure.

Conversely, there is some evidence also that the State's percentage of voting shares is declining over this period also.

As for dominant ownership the number of firms with a group of dominant owners has remained quite stable, in addition, firms with an outside dominant group of owners has also increased. In contrast firms with a group of inside dominant owners has decreased by approximately 6%.

Managerial turnover also seems to have slowed over the period from 1996 to 1997, perhaps suggesting that this process is reaching completion.

Lastly, the interaction variable which represents outside ownership has more than doubled over the period 1994-7.

As for exporting intensity, this is low for all three countries, compared to other transition economies, for example Filatotchev *et al.*, (2001) find that average export intensity for Hungary in 1997 is 39%. In the case of Russia, export intensity has increased during the period 1994-1997. As for Belarus and Ukraine, export intensity increased during 1994-1996, and has fallen during 1996-1997.

Table 4: Correlation table

Table four (please see over) illustrates the correlation table using the Pearson correlation coefficient for continuous variables and point biserial correlation for dichotomous variables.

The dependent variable, export intensity, is measured in 1997, and independent variables are measured in 1996. Refer to variable description above for codes

The correlation matrix reveals several interesting associations.

Firstly, export intensity is significantly correlated to industrial decline and firm size (both positively, at 5% and 1% levels respectively), reflecting perhaps, that industrial decline acts as push factor to external markets and that firm size represents resources or political clout

assisting export activity. These results differ from those of Aw and Batra (1998) who find that small to medium sized firms are more likely to be exporters, yet agree with those of Delgado *et al.*, (2001) who find that firm size is positively associated with exporting.

Table four: correlation table

	Eabr	For	Emp	Out	Gov	Bin	Bout	Dom Own	Dom Out	Intout	Newd ir	GD	Lem p
Eabr	1.00	-0.001	0.08	-0.05	-0.05	0.04	-0.07	0.07	0.02	-0.03	-0.002	0.18*	0.32**
For	-0.001	1.00	-0.09	0.14	-0.09	-0.05	0.10	0.05	0.01	0.10	-0.1	-0.001	0.007
Emp	0.08	-0.09	1.00	-0.64**	-0.49**	0.56**	-0.43**	0.24*	-0.29*	-0.43*	-0.17*	0.06	-0.05
Out	-0.05	0.14	-0.64**	1.00	-0.17*	-0.46**	0.51*	-0.16*	0.34*	0.69*	0.14	0.07	0.03
Gov	-0.05	-0.09	-0.49**	-0.17*	1.0	-0.23**	-0.10	-0.004	-0.05	-0.12	0.15	-0.017*	0.07
Bin	0.04	-0.05	0.59**	-0.46**	-0.23**	1.00	-0.83*	0.36*	-0.19*	-0.71*	-0.10	0.20*	-0.02
Bout	-0.07	0.10	-0.43**	0.5**	-0.10	-0.83**	1.00	-0.34	0.29*	0.87*	0.12	-0.014	-0.02
DomO wn	0.07	0.05	0.24**	-0.16**	-0.004	0.36**	-0.34*	1.00	0.17*	-0.23*	-0.07	0.14	-0.018
DomOu t	0.02	0.01	-0.29**	0.34**	-0.05	-0.19*	0.29*	-0.17*	1.00	0.28*	0.004	0.06	-0.09
Intout	-0.03	0.10	-0.43**	0.69**	-0.12	-0.71**	0.87*	-0.23*	0.28*	1.00	0.09	-0.014	0.003
Newdir	-0.002	-0.1	-0.17*	0.14	0.15	-0.10	0.12	-0.07	0.004	0.09	1.00	0.01	0.07
GD	0.18*	-0.01	0.06	0.07	-0.17*	0.20*	-0.14	0.14	0.06	-0.14	0.01	1.0	-0.02
Lemp	0.32**	0.007	-0.05	0.03	0.07	-0.02	-0.02	-0.02	-0.09	0.003	0.07	-0.002	1.0

*** Significant at 0.001; ** Significant at 0.01; * Significant at 0.05; † Significant at 0.1

Interestingly the percentage of voting shares held by outsiders and employees are both positively related to the number of board seats held by these shareholders. This reflects that share ownership is mirrored in the composition of the board.

The 1994 law was designed to ensure that only one third of board members are insiders, which attempted to prevent ownership structure of firms being mirrored in their board structure, however this law was largely ignored by many firms.

As for insider ownership this is negatively correlated to the variable representing a change in directorate, providing evidence that insiders do not enforce changes in directorship.

Lastly, the presence of a group of dominant outside owners is negatively related to the number of board seats held by insiders and negatively correlated to government shareholding.

As for the chapter concerning foreign partner selection we have the following descriptive statistics:

Table 5: Extent of collaboration and firm seeking foreign partners

	% of firms with a foreign partner in 1996	% of firms seeking a foreign partner in 1996
Russia	27	56
Belarus	51	63
Ukraine	24	71
OVERALL	34	63
	% of firms with a foreign partner in 1997	% of firms seeking a foreign partner in 1997
Russia	15	28
Belarus	16	61
Ukraine	24	60
Overall	18	50

Table five alarmingly reveals that the number of firms with a foreign partner in all countries has dropped over the period 1996 to 1997. This may be caused by joint venture conflict or macroeconomic instability; unfortunately the data does not allow us to extrapolate why the number of collaborations has declined. However the fact that the number of firms *seeking* a foreign investor has also declined may reflect that firms in a similar industry have had

negative experiences with foreign partners, or that firms have adapted their expectations if searching for a foreign partner is costly.

Table 6: Why do you have or are seeking a foreign partner?*

	Introduction of new technology for existing products	Introduction of new technology for new products	Rehabilitation of existing machinery	Training managers in marketing, finance etc	Access to foreign markets	General advice and consultancy
Russia	5.1(2.4) [^]	5.6(2.1)	5.0(2.2)	3.9(2.2)	4.9(2.4)	2.6(1.8)
Belarus	5.8(1.5)	6.3(1.1)	6.1(1.1)	4.7(1.9)	5.8(1.8)	4.2(2)
Ukraine	5.9(1.9)	6.1(1.6)	5.9(1.8)	4.9(2.2)	5.6(2.1)	4.5(2.2)
OVERALL	5.5(2.1)	5.9(1.7)	5.6(1.9)	4.5(2.1)	5.4(2.2)	3.4(2.2)

*mean score on Likert scale

[^]= standard deviation in parentheses

Table six shows that one of the main reasons for having/seeking a foreign partner is to obtain technology for new products in all three countries (see question 18 in the Questionnaire for this section). Surprisingly access to foreign markets is not particularly important, given unstable domestic demand.

Table 7: Do you consider your firm to be attractive to a foreign investor?

	% of firms who consider their firm to be attractive to a foreign investor?
Russia	56
Belarus	71
Ukraine	79
OVERALL	69

Table seven reflects some differences in how managers view their firms and how potential foreign partners view firms in this region. Clearly managers have overestimated their attractiveness, as when we examine table eleven which shows the extent of established links the level is much lower than we would imagine given table thirteen's results.

Table 8: If not, Why?*

	Majority stake owned by employee shareholder	Size of needed investment	Unstable demand	More attractive industries elsewhere	Management hostility to outsiders	Lack of understanding of company potential	Shortcoming in skill base	Ecological problems
Russia	2.9(2.5) [^]	4.9(2.3)	4.7(2.0)	4.1(2.5)	1.8(1.2)	2.9(0.2)	2.9(1.5)	1.8(1.5)
Belarus	3.4(2.8)	3.5(2.4)	3.2(2.3)	2.7(2.5)	2.1(1.8)	2.8(2.2)	2.8(2.2)	2.1(1.7)
Ukraine	2.7(2.6)	3.4(2.3)	4.9(2.1)	5.3(2.4)	1.8(1.7)	2.2(2.0)	4.3(2.3)	3.1(2.5)
OVERALL	3(2.6)	3.8(2.4)	4.3(2.2)	4.0(2.6)	1.9(1.5)	2.6(2.0)	3.3(2.0)	2.3(1.9)

*mean score on Likert scale

[^]= standard deviation in parentheses

For both Russia and Belarus the size of necessary investment is a major deterrent to foreign investors. As for Ukraine it seems that there are more attractive firms in the same industry.

Table 9: If yes, Why?

	Acquisition of undervalued assets	Access to Russian market via local production	Access to Russian market via acquisition and closure	Access to Russian technology	Access to knowledge of local conditions	Preservation of former links
Russia	5.5(1.9)	5.4(1.80)	3.3(2.3)	1.7(1.1)	3.2(1.7)	2.8(2.1)
Belarus	4.1(2.5)	4.2(2.4)	1.9(1.7)	2.1(1.8)	3.6(2.4)	3.7(2.5)
Ukraine	4.4(2.40)	5.8(1.8)	2.4(2.1)	3.1(2.0)	4.9(2.1)	4.7(2.2)
OVERALL	4.7(2.4)	5.1(2.10)	2.5(2.1)	2.3(1.9)	3.9(2.4)	3.7(2.4)

Lastly the table above shows that Russian managers believe their firms to be attractive due to their undervalued assets, which could lead to resentment and conflict, a possible reason why the number of firms with a foreign partner has declined. As for Belarus and Ukraine the most important factor appears to be access to the Russian market, thus managers there anticipate they will become export platforms to the larger Russian market.

4.2 EXPLORATORY DATA ANALYSIS : NON PARAMETRIC TESTS

Having carried out preliminary skewness tests it became apparent that all of the variables were non normally distributed,² apart from the insider ownership variable, EMPL94 and EMPL96. This meant that in order to test if there is a significant difference between ownership structures and export activity from 1994 to 1996 it was imperative to use the non parametric Wilcoxon test³, which does not make any assumptions about population distributions and variance.

The results of these tests are shown below and are informative of the evolution of ownership and form the basis of the explanatory data analysis. They examine the differences in means in 1994 and 1996.

Table 10: Non parametric tests for Russia, Ukraine and Belarus pooled

	Export intensity	Foreign ownership	Outsider ownership	Institutional ownership	% of board seats held by insiders	% of board seats held by outsiders	Outsider corporate control
Z^a	2.89**	-1.83†	-5.4***	-2.9**	-1.9†	-3.3**	-2.9**

^a Wilcoxon Signed Ranks test. ***p<0.001, **p<0.01, *p<0.05

Table 11: Parametric tests for Russia, Ukraine and Belarus pooled

	Insider ownership
t statistic	4.1***

***p<0.001, **p<0.01, *p<0.05

Tables 10 and 11 reveal that there is a significant difference between ownership structure and export activity in 1994 and 1996. For example, export intensity is quite strongly and significantly different between 1994 to 1996. Also outside ownership is significantly different in this period too, perhaps representing a move away from majority insider ownership, as mean levels of outsider ownership appear to have increased (see

² By using the Kolmogorov and Smirnov test, skewness vales (a value greater than 1 refers to a non normal distribution) and kurtosis graphs, non normality could be deduced.

³ See Kinnear and Gray, 1999, pp164-167.

descriptive statistics table). Blasi *et al.*, (1997) document a similar finding from their survey on Russian ownership structures (p54).

As for board structure, there is a weak significant difference between the average number of seats held by insiders in 1994 and 1996, and a *strong* significant difference between the average number of seats held by outsiders in 1994 and 1996. Therefore, when data from the three countries are pooled, we find a situation where changes in ownership structure are matched with changes in board structure.

Running the tests separately for each country yield slightly different results.

Table 12: Non parametric tests for Russia

	Export intensity	Foreign ownership	Outsider ownership	Institutional ownership	% of board seats held by insiders	% of board seats held by outsiders	Outsider corporate control
Z^a	-1.5	1	-2.7**	-1.5	-1.6†	-3.4**	-2.2*

^a Wilcoxon Signed Ranks test. *** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$

Table 13: Parametric tests for Russia

	Insider ownership
t statistic	0.5

For Russia it appears that there are significant differences between outside ownership, insider board representation, outsider board representation and the level of corporate control for outsiders from the period 1994 and 1996. However, for mean levels of insider ownership, export intensity, and foreign ownership between 1994-1996, the differences are insignificant. Presumably representing that insider ownership in Russia has not fallen that dramatically, and that foreign ownership and export intensity has remained fairly static.

Table 14: Non parametric tests for Belarus

	Export intensity	Foreign ownership	Outsider ownership	Institutional ownership	% of board seats held by insiders	% of board seats held by outsiders	Outsider corporate control
Z ^a	-1.4	-1.3	-4.3***	-2.7**	-0.2	-0.8	-1.2

^a Wilcoxon Signed Ranks test. ***p<0.001, **p<0.01, *p<0.05

Table 15: Parametric tests for Belarus

	Insider ownership
t statistic	-2.1*

***p<0.001, **p<0.01, *p<0.05

As for Belarus there were significant differences in mean levels of outside, institutional and insider ownership during the period 1994-1996. Yet mean levels of exporting intensity, board structure and foreign ownership has not changed during the period 1994-1996.

Table 16: Non parametric tests for Ukraine

	Export intensity	Foreign ownership	Outsider ownership	Institutional ownership	% of board seats held by insiders	% of board seats held by outsiders	Outsider corporate control
Z ^a	-2.2*	-1	-2.7**	-1.2	-0.4	-1.1	-0.9

^a Wilcoxon Signed Ranks test.

***p<0.001, **p<0.01, *p<0.05

Table 17: Parametric tests for Ukraine

	Insider ownership
t statistic	1.8*

***p<0.001, **p<0.01, *p<0.05

Lastly, for Ukraine export intensity, insider ownership and outside ownership are all significantly different during this period.

From these tests we can see that board representation of insiders and outsiders has not changed significantly in Belarus and Ukraine, while the level of outsider ownership has changed significantly in all three countries. However foreign ownership has only changed significantly when all three countries are pooled. Furthermore we can say that changes in the percentage of voting shares of different types of owners have not been mirrored in board structure.

In order to test whether a firm has a group of dominant owners or dominant insiders/dominant outsiders in both 1994 and 1996, a Chi test was applied⁴, as this is the appropriate test for dichotomous variables. If the Chi square statistic is significant then we can conclude that the number of firms which have a group of dominant owners etc. in 1994 is different in 1996.

Table 18: Chi test statistics for dichotomous variables (1994-1996)

	Group of dominant owners	Group of dominant insider owners	Group of dominant outsider owners
All 3 countries	4.7*	8.2**	21.3***
Russia	13.8***	13.6	13.0*
Ukraine	0	10.3**	10.2***
Belarus	a		

^a all differences insignificant, ***p<0.001, **p<0.01, *p<0.05

Firstly, from table 18 it is clear that the number of firms with various types of dominant ownership in Belarus in 1994 is not significantly different from the number of firms in 1996. In Russia, the number of firms with a group of dominant owners and a group of outside dominant owners in 1994 is significantly different from the number of firms in 1996. Lastly, in the case of Ukraine the number of firms with a group of dominant insiders and outsider owners in 1994 is significantly different from in 1996⁵.

Before more sophisticated analysis was applied, Mann Whitney U⁶ tests were applied in order to test the equality of means of export intensity in 1996 for different types of ownership structure.

⁴ Namely the McNemar test, see Kinnear and Grey, 1991, p165.

⁵ Comparisons with other studies cannot be made as my study deals with *groups* of dominant owners.

Table 19: Testing for the equality of means of export intensity in 1996 for different ownership types using Mann U Whitney test for Russia, Ukraine and Belarus.

	Pooled Z statistic	Russia Z statistic	Ukraine Z statistic	Belarus Z statistic
For firms with or without:				
outside ownership	-1.8†	0.2	-0.3	-0.7
foreign ownership	-0.9	-2.3†	na	-0.5
institutional ownership	-1.2	-0.3	-0.4	-1.4†
dominant owner	-0.1	-0.2	-0.9	-1.4
a new director	-0.3	-0.4	-0.1	-0.01
a dominant outsider	-0.9	-0.4	-0.8	-0.9
insider board ownership	-1.9†	-2.0*	-0.1	-0.7
outsider board ownership	-2.2*	-2.2*	-0.4	-0.2

***p<0.001, **p<0.01, *p<0.05, †p<0.1

By referring to table 19 several observations can be made, by pooling the data for the three countries average export intensity levels are significantly different for firms with outside ownership from those without outside ownership. Similar findings hold for firms with insider board representation and those without, and again for firms with and without outsider board representation.

Foreign and non foreign owned firms' average export intensity levels are not significantly different, in addition to firms with institutional and non institutional ownership. Whether a firm has had a new director or a dominant owner also does not lead to a significant difference in export intensity levels, suggesting that outsider ownership and board representation is a more important factor in determining the level of export intensity.

Examining table 19 for each country separately reveal slightly different results. For Russia alone, it appears again that average levels of export intensity are significantly different in firms with insider and outsider board representation from those without. Interestingly, export intensity levels are also significantly different in firms with foreign ownership and those without, therefore the hypothesis concerning foreign ownership may have pertinence.

⁶ Mann U Whitney tests are suitable for 2 independent samples, see Kinnear and Grey (1999), p106.

As for Belarus different types of ownership structure or corporate governance do not appear to lead to different average export intensity levels, maybe because state control is so predominant⁷.

In Ukraine the position is similar to Belarus except that firms with institutional ownership have significantly different mean levels of export intensity from those firms without institutional ownership, thus the hypotheses concerning institutional share ownership may prove useful, in determining export activity

Aside from tables 5-9 in this chapter exploratory data analysis concerning foreign partner selection is detailed in tables 2-5 of chapter six.

4.3 Repeated Measures

It was seen in the previous chapter that Bergh (1995) highlights the benefits of adopting a repeated measures design, whereby subjects are measured two or more times for a particular dependent variable.

Descriptive statistics for the independent variables in this procedure (see chapter three for a description) will be shown below.

In order to avoid the problem of missing data the mixed design repeated measures design was undertaken for the modified data using the EM algorithm procedure, with the intention of improving the precision of the results⁸.

⁷ For Belarus in 1995 the average state percentage of voting shares was as high as 27.8%. State control is also known to be high, which can be expected to affect formal ownership structures.

Table 20: Descriptive statistics for the independent variables: 1994-1997^a.

	1994	1996	1997
Insider's share ownership			
Group 1	65.9	63.8	57.4
Group 2	72.5	60.3	60.9
Foreign share ownership			
Group 1	0.4	0.4	0
Group 2	0.2	1.4	1.4
Outsider's share ownership			
Group 1	10.6	19.8	30.6
Group 2	15.2	21.7	22.6
Institutional share ownership			
Group 1	5.1	8.3	10.9
Group 2	3.0	5.6	7.8
% of seats held by insiders			
Group 1	78.9	74.2	79.6
Group 2	77.5	77.8	77.4
% of seats held by foreign owners			
Group 1	0	0.3	0.2
Group 2	0	0	0
% of seats held by outsiders			
Group 1	10.9	16.9	16.8
Group 2	7.6	8.8	13.9

^a Group 1 has decreasing exports over the period 1994-1997, for which n =53 , group 2 has increasing exports over the same period for which n=62.

⁸ The repeated measures analysis was also carried out using the dataset with missing values, the main results were that foreign ownership, institutional ownership and time all impact upon whether a firm has increased or decreased its export intensity. Board structure appears not to play a role.

Again the results of the Mauchly's sphericity tests in table 21 show that the assumptions of sphericity have been violated.

Table 21: Mauchly's test of sphericity

	Mauchly's W	Approx. Chi square	significance
Ownership	0.1	1079.7	0.00
Time	0.8 ^a	11.8	0.003
Ownership*Time	0.1	1978.5	0.000

^a As the Green House Geisser epsilon is greater than 0.75 the Hunyh-Feldt epsilon shall be used for the time factor in order to adjust the F statistic.

Table 22: Tests of within subjects effects corrected for violations in sphericity.

	Greenhouse -Geisser epsilon	Adjusted F statistic	df	Sign.	Multivariate F statistic	Sign.
Ownership	0.2	265.7	1.9	0.000	331.0	0.000
Time ^a	0.9	4.9	1.7	0.01	4.7	0.01
Ownership *Time	0.3	5.7	4.4	0.000	4.4	0.00

^a The Hunyh -Feldt epsilon is adopted.

In table 22 we can see that the two main effects and the interaction are significant. For example, the main effect of ownership is significant ($F(1.9,17) = 265.7, p < 0.000$). Thus we can conclude that ownership structure is different for firms (ignoring the time factor) with increasing and decreasing export intensity. The time main effect is also significant, so we can conclude that whether a firm has increasing or decreasing export activity is modified over time. Also the multivariate method produces the same significance levels as the univariate technique.

However by examining the tests of within contrasts in table 23 it is apparent that there are significant differences in export levels between specific ownership types.

Table 23: Tests of within subjects contrasts

	F	Significance
Ownership*time Foreign share ownership vs. Insider ownership, 1996 vs.1997	6.6	0.01
Outsider ownership vs. Institutional ownership, 1994 vs 1996.	22.1	0.000
Outsider ownership vs. Institutional ownership, 1996 vs. 1997	6.1	0.02
Institutional ownership vs. Outsider ownership, 1994 vs.1996.	16.4	0.000
% of board seats held by insider vs. Institutional ownership, 1994 vs. 1996.	8.2	0.006
Ownership*time*Xchange^a Foreign ownership vs. Insider ownership, 1994 vs. 1996	3.5	0.07
Outsider ownership vs. Foreign ownership, 1996 vs. 1997.	4.3	0.04
% of board seats held by foreign owners vs. % of board seats held by insiders, 1994 vs. 1996.	2.6	0.1

^aXchange is the between subjects factor, and compares firms with increasing and decreasing levels of export intensity.

Please see chapter one for a list of hypotheses.

For the first contrast comparing foreign ownership and insider ownership from 1994 to 1996 we have a significant result. This reflects that an increase in foreign share ownership, compared to an increase in insider ownership is associated with firms with increasing export intensity during the period 1996-7. This analysis provides support for hypothesis 5.

From table 23 it is clear that outsider share ownership compared to foreign ownership, when 1994 is compared to 1996, foreign ownership is associated with those firms with increasing export intensity. This provides support for H3.

The contrast between outsider ownership and institutional ownership, when 1994 and 1996 are compared, shows that an increase in institutional ownership compared to other outside ownership is positively linked to firms with increasing export intensity, this result was also found in analysis, where missing values were not imputed (not presented here). From this we can tentatively accept hypothesis 14b.

Next, we arrive at another significant contrast: that which compares the percentage of board seats held by insiders compared to institutional share ownership, when 1994 is compared to 1996. Thus, we can conclude that share ownership held by institutions is linked with firms with an increasing export intensity, thus this enables us to accept hypothesis 14b.

Next if we come to the ownership, time and between subjects interaction, there are now several contrasts which are significant. Again foreign ownership compared to insider ownership for the years 1994 to 1996 is significant. This shows that an increase in foreign ownership compared to insider ownership, is linked to firms with increasing exports, also for the period 1994-1996.

Secondly the contrast which compares outside ownership with foreign ownership, between 1996 and 1997 is significant, and shows that an increase in outside ownership over this period is associated with firms with increasing export intensity.

Finally the contrast which compares the percentage of board seats held by foreigners with those held by insiders, from 1994 to 1996 is significant at the 10% level. This reflects that the decline in the percentage of seats held by foreigners is associated with those firms experiencing a decline in export intensity, finding indirect evidence to support hypothesis 9. Thus by adopting the repeated measures design with imputed missing values we arrive at the following results: the contrast between foreign and outside ownership is significant for the whole period of 1994 to 1997 and contrasts between the percentage of board seats held by insiders compared to institutional ownership, and the percentage of board seats held by foreigners (for 1994 to 1996) are significant⁹.

Table 24: Summary table

KEY RESULT	
1	Insider ownership and control decreased over the period 1994-96.
2	Outsider ownership increased yet board representation has not increased by the same magnitude.
3	Foreign ownership has increased only slightly.
4	Institutional ownership has increased.
5	The number of firms with a dominant owner has remained stable.
6	In Russia export intensity has increased (1994-1997), yet in Ukraine and Belarus export intensity has increased during 1994-6, but declined in 1996-7.
7	Firms with a foreign partner has declined during the period 1996-1997.
8	Firms seeking a foreign partner has declined during the period 1996-1997.
9	For pooled data average export intensity levels are different for firms with outside ownership and those without.
10	For pooled data average export intensity levels are different for firms with insider board representation and those without.
11 FROM REPEATED MEASURES	Ownership structure is different for exporting and non exporting firms
12 FROM REPEATED MEASURES	Contrast between foreign and outside ownership is significant for the period of 1994-7.

Observations relate to the period 1994-6 or 1997.

⁹ Thanks to Dr T. Mickiewicz for the following point: the repeated measures technique does have one disadvantage- differences between groups may result from the fact that groups of firms have different characteristics, such as size etc., for which the technique does not control.

4.4 MODELS FOR ESTIMATION

In chapter five the following models were estimated, where the dependent variable is measured in 1997 and 1996, by a variety of techniques:

Model 1: Export intensity or propensity_t = α + log of employees_{t-1}¹⁰ + industrial decline¹¹ + log of investment_{t-1} + decline in state ownership_{t-1} + % of shares held by foreigners_{t-1} + % of shares held by outsiders_{t-1} + % of shares held by institutions_{t-1} + % of shares held by insiders_{t-1} + presence of a new director_{t-1} + Russian country dummy + Ukrainian country dummy + ε_t

Model 2: Export intensity or propensity_t = α + log of employees_{t-1} + industrial decline + log of investment_{t-1} + % of seats held by insiders_{t-1} + % of seats held by foreigners_{t-1} + % of seats held by outsiders_{t-1} + % of seats held by insiders_{t-1} * % of shares held by insiders_{t-1} + Russian country dummy + Ukrainian country dummy + ε_t

Model 3: Export intensity or propensity_t = α + log of employees_{t-1} + industrial decline + log of investment_{t-1} + presence of a group of dominant owners_{t-1} + presence of a group of outsider dominant owners_{t-1} + Russian country dummy + Ukrainian country dummy + ε_t

As for chapter six the following model was estimated for the dependent variable in 1997 and 1996, by using logistic regression.

Model 1: Incidence of having a foreign partner_t = α + export intensity_{t-2} + presence of a new director_{t-2} + firm size_{t-2} + required investment_{t-2} + foreign partner's perception of local market + foreign partner's perception of local technology + firms aspiration for gaining access to technology + firms aspiration for gaining access to markets + managerial resource allocation to domestic market + greater than average insider shareholding_{t-2} + greater than average foreign shareholding_{t-2} + Russian country dummy + Ukrainian country dummy + ε_t

Model 2: Incidence of retaining a foreign partner_t = α + export intensity_{t-2} + presence of a new director_{t-2} + firm size_{t-2} + required investment_{t-2} + foreign partner's perception of local market + foreign partner's perception of local technology + firms aspiration for gaining access to technology + firms aspiration for gaining access to markets + managerial resource allocation to domestic market + greater than average insider shareholding_{t-2} + greater than average foreign shareholding_{t-2} + Russian country dummy + Ukrainian country dummy + ε_t

¹⁰ When the dependent variable is measured in 1996, the independent variable is lagged by two years

(t-2).

¹¹ Description given on page 130 under variable description.

Model 2b: Incidence of retaining a foreign partner_t = α + firm size_{t-2} + investment_{t-2} + capacity depreciation_{t-1} + labour productivity_{t-1} + job gains_{t-1} + export intensity_{t-1} + profit_{t-1} + liabilities_{t-1} + Russian country dummy + Ukrainian country dummy + ε_t

Model 3: Incidence of gaining a foreign partner_t = α + export intensity_{t-2} + presence of a new director_{t-2} + firm size_{t-2} + required investment_{t-2} + foreign partner's perception of local market + foreign partner's perception of local technology + firms aspiration for gaining access to technology + firms aspiration for gaining access to markets + managerial resource allocation to domestic market + greater than average insider shareholding_{t-2} + greater than average foreign shareholding_{t-2} + Russian country dummy + Ukrainian country dummy + ε_t

CHAPTER FIVE: OWNERSHIP AND CORPORATE GOVERNANCE EFFECTS UPON EXPORTING IN THE FORMER SOVIET UNION.

5.0 INTRODUCTION AND RESEARCH OUTLINE

This chapter will seek to determine how the corporate governance structure in Russia, Ukraine and Belarus has effected one element of strategic restructuring, namely export re-orientation at the firm level.

The literature presents several definitions of corporate governance, for instance it has been described as the pattern of share-holding within the firm (ownership structure) and distribution of control rights among share-holders by the EBRD, 1995. Shleifer and Vishny (1997) state that corporate governance deals with ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. However, it is now widely recognised by the OECD Principles of Corporate Governance that good corporate governance should not only be concerned with share-holders but other stakeholders, such as investors and employees. More specifically, *“corporate governance provides the structure through which the objectives of the company are set and the means of attaining these objectives and monitoring performance are determined,”* Kuznetsova and Kuznetsov (2001).

All of these definitions shall be taken into account in this analysis and thus the impact of voting rights, board composition and the existence of groups of dominant share-holders¹ on export activity shall be examined.

Hypotheses concerning foreign ownership, the insider/outsider ownership debate and the presence of groups of dominant owners, in addition to other corporate governance factors, such as board structure will be tested using linear and logit regression. This is suggested by Wakelin (1998) who proposes that firstly, export propensity should be used, making the use of logit regression appropriate, and secondly export intensity.

Next, weighted least squares regression, the fixed effects model and repeated measures analysis shall be used to deal with heterogeneity and the ‘time’ issue.

In order to deal with endogeneity problems and selection bias, common to studies of transition economies, ownership and corporate governance variables shall be lagged, in order to alleviate causality problems, as advocated by Bromiley (1991), who shows that ownership structures can have an impact on firms in subsequent years. Filatotchev and Mickiewicz (2001) also highlight that changes in corporate governance do not have an immediate effect on performance.

Studies of the impact of ownership on firm performance in Western Economies and in transition economies shall be described in 5.2-5.6, along with the hypotheses, and the evolution of ownership and corporate governance in this sample, while sections 5.7- 5.10 shall deal with analysis, and 5.11 concludes.

RESEARCH OUTLINE

The literature described below provides evidence that ownership may effect diversification², and thus firm performance.

For example, Morrissey and Filatotchev (2001) claim that, “*ownership and governance structures of firms underpin their ability to integrate into the world economy*,” (p1).

Indeed, exporting decisions involve corporate risk taking, which may be affected by ownership structure.

Cavusgil (1984) documents that within the exporting literature additional research should be carried out examining the organisational and internal characteristics of firms and their impact upon export activity. This will provide an understanding of the characteristics associated with export activity at the firm level. Also it is important to take into account that Russia has a highly concentrated export product structure³.

Cavusgil shows that variations in export activity can be explained by managerial expectations towards exporting, technology level of the firm, managerial attitudes towards risk and resource allocation for exporting policy. However Cavusgil ignores one important

¹ Shleifer and Vishny (1997) also examine other corporate governance mechanisms, such as take-over threat, yet they are not covered in this chapter. Klein (1998) also examines the impact of board *committee* structure on performance.

² Several studies cited in this chapter consider exporting to be a part of diversification.

³ Radsoevic and Hottop (1999) find that in 1994 the export of petroleum oils accounted for 28.20% of total trade, Radsoevic, Hottop and Bishop (2001) find that in 1999 Russia's export structure has largely remained static during the period 1994-1999.

organisational characteristic, that of the impact of ownership structure of the firm on exporting; this study hopes to fill this void.

Dosoglu- Guner (2001) also states that the possible link between ownership and exporting decisions has been largely ignored in the literature. Ownership might act as a crucial component of exporting activity due to its influence upon firm commitment to international expansion and external strategy.

The Dosoglu -Guner study examines the impact of organisational culture and ownership type on exporting intentions of 175 US manufacturing firms and finds that an adhocracy⁴ culture is positively associated with firm intention to export.

Moreover, she finds that externally controlled firms exhibit a higher intention of exporting, whereby power is dispersed and where dominant stock holders are not part of the management team. Owner controlled firms (those run by families) are least likely to intend to engage in export activity.

While my study largely ignores the impact of organisational structure it intends to improve on the above study by examining export intensity and propensity⁵, as opposed to export intention, the latter could be viewed as very subjective, by ignoring differences between “might be interested” and “not interested” groups of firms.

In addition I shall include the possible time lags between ownership structure and exporting behaviour to account for selection bias. Furthermore I shall use a wider choice of ownership variables, such as insider, outsider, foreign and institutional ownership, along with variables to represent the existence of groups of dominant ownership. Also I shall extend this analysis to the composition of board structure.

Buck *et al.*, (2001) defend this approach, they state that international trade theory is limited in this context, “*particularly as productivity related variables are subject to large measurement errors in the FSU,*” (p 51). For example, the work by Gaddy and Ickes

⁴ This is defined as entrepreneurial, adaptable, risk taking and future orientated. This is an environment that could be expected to view exporting as part of their corporate culture.

⁵ As recommended by Buck *et al.*, (2000) export propensity and intensity are used. They note that export propensity maybe a useful measure in the FSU environment as “*any actual export sales, however small, represent a considerable achievement,*” p20. In a similar vein, Aw and Batra (1993) note that the very activity of exporting, (independent of levels) has a significant impact (on productivity).

(1998) highlights the fact that Russia is characterised by a “virtual economy”, which must be borne in mind when analysing data⁶.

Thus they recommend that the incentives of firms in transition economies be examined, which in turn lie within the structure of ownership and control. Furthermore Filatotchev *et al.*, (2000) claim that the majority of research has so far failed to examine the impact of privatisation on exporting activities in the FSU, along with their detailed studies, this chapter hopes to shed some light on the matter.

The Transition Report 2001 highlights that the integration into the world economy and the benefits from globalisation are likely to be “*far reaching*” for the transition economies, as it will provide access to global markets, technology and capital (p5). Therefore one of the contributions of this study will be to examine how ownership structure affects the ability of firms to integrate into the world economy, which is deemed a “*matter of survival*” by the Transition Report, 2001.

5.1 ANALYTICAL FRAMEWORK

Section 5.2 will document studies of the impact of ownership on performance in Western or developed economies⁷. This strand of literature is pertinent in a study of the effects of ownership structure on exporting activity for two reasons. First, in some research it has been postulated that exporting itself, is a measure of performance.

For example, Douglas (1996) in a study of small and medium firms in Peru, adopts export sales volume as a performance measure. She examines the impact of firm size, age, managerial strategies (such as the marketing mix) and motives on performance.

In the transition environment Filatotchev *et al.*, (1999) look at the impact of firm performance on the probability of managers buying shares from employees in Russian firms. Among the performance measures used are labour productivity, pre tax profits and export sales. Thus it is clear that, in at least, developing countries and transition economies,

⁶ However, *Russian Economic Trends* for July 2001 cites that Russian businesses are managing to increase the share of monetary payments, as a total of industry sales, yet this is still only to a level of 75%.

⁷ However it is acknowledged that in more recent research by Demsetz and Villalonga (2001) and Bishop, Mickiewicz, Filatotchev (2001) that ownership is treated as an endogenous variable, and consequently no correlation is found between firm performance (measured by return on assets) and ownership structure, however they do find a relationship between labour productivity and ownership.

exporting has been used as a performance measure, thus the ownership-performance literature will be useful when analysing the relationship between ownership and exporting. Bornstein (2000) and Filatotchev and Mickiewicz (2001) argue that there may be difficulties in measuring performance in transition economies. Filatotchev and Mickiewicz (2001) state that *“the transition environment is characterised by radical adjustment...In such a dynamic environment it becomes...important not to disregard apparent time lags between the three stages...1) changes in corporate control regimes, 2) induced changes in strategies...which result in restructuring, 3) post adjustment improvement in efficiency indicators.* As a result, several assumptions must be made concerning the ownership- exporting-performance relationship.

The doctrines of international business and strategic management state that exporting is a strategy. For example, Hitt *et al.*, (1997) note that international diversification plays a key role in the strategic behaviour of large firms. Moreover, McDougall and Oviatt (1996) find that successful internationalisation (measured by the percentage of foreign sales to total sales) requires a change in strategy, in their study of 62 manufacturing firms in the US. Furthermore they note that the relationship between firm performance and internationalisation is moderated by firm strategy and industrial environment. Yet, previous internationalisation literature fails to consider that corporate governance can be treated as an antecedent to export promoting strategies.

More generally, Child (1972) notes that when a firm's environment changes, strategies must also be changed, to be congruent with the new environment. This is highly applicable to firms in the FSU, the dramatic change in trading conditions⁸ make it imperative for firms to adapt their strategy in order to be able to trade effectively with non CIS countries.

Theoretical work by Barker and Duhaime (1997) has also asserted that *“strategic change is a key element of many successful turnarounds⁹,”* (p13).

MacBean (2000) states that in transition economies *“managers...were almost cut off from foreign markets as foreign trade was the monopoly of the state trading*

⁸ Hoekman and Djankov (1996) note that the collapse of the CMEA, meant that shifting exports to hard currency markets was crucial, yet a lack of knowledge of foreign quality standards, foreign tastes and distribution networks made this process difficult, see also Smith, (1995).

⁹ A turnaround is deemed necessary when a firm is suffering from performance decline, or an organisational crisis, which could be applicable to the FSU. The collapse of the CMEA and liberalisation caused an organisational crisis for some firms in the region.

companies” (p5). In these countries managers would need to change their strategy to one of upgrading production techniques, acquisition of new machinery and skills to successfully export.

Similarly, McDougall and Oviatt note that successful internationalisation may require that *“mangers may need to learn...about foreign laws, language, culture and competitors,”* (p27.) The identity of firms’ owners and managers is likely to affect their ability to meet these requirements and the formulation of a suitable internationalisation strategy, which is the key theme of this chapter: how does the ownership structure affect exporting activity?

However, why might managers decide to select the strategy of exporting?

Hitt *et al.*, (1997) document that international diversification¹⁰ offers advantages to firms, for example, foreign markets allow greater firm growth and present market opportunities, that firms selling solely on domestic markets would not enjoy. Furthermore this kind of diversification allows firm to exploit internalisation¹¹, these benefits present themselves in the guise of *“economies of scale, scope and learning.”* (p771). For example, previous research by Kochar and Hitt (1995) showed that increased learning result from the economies of scope gained by international diversification. Thus exporting can be viewed as a strategic outcome of the strategic decision and choice process of managers and owners to improve firm performance by exporting activity. For example, in the West it has been found that one of the principal managerial motivations for exporting was long term profit through market diversification and long term growth (see Simpson, 1973). More succinctly, *“managers of exporting firms tend to have a positive attitude towards exporting as they regard it as one of the critical elements of their company’s growth, profit and success,”* (Dosoglu-Guner, 2001, p73).

Belkaoui (1998) assumes a unique approach by adopting multivariate adaptive regression spline modelling, in order to test if the relationship between the degree of internationalisation and performance¹² is non linear in US multinational enterprises, over the period 1985-1993.

¹⁰ Hitt *et al.*, (1997) define internationalisation as *“the expansion across borders of global regions and countries into different geographic locations, or markets,”* p767. We can assume that exporting is part of international diversification.

¹¹ Internalisation refers to the operation of performing many activities internally, (see Rugman, 1981).

¹² He measures the degree of internationalisation by foreign revenues divided by total revenues and performance by return on assets.

His results do find evidence of a non linear relationship: the relationship is positive between 14% and 47%, but negative at degrees of internationalisation below 14% and greater than 47%, concluding that more *“multi-nationality”* is not always better (p319).

The economics literature also documents evidence of the positive effects of exporting, in the learning by exporting field.

Bleaney *et al.*, (2000) find that there is evidence of learning by exporting (*“or in other words whether there is feedback from exporting to firm performance”*, p1) in firms in Russia, Ukraine and Belarus. Their results show that current employment is significantly and positively related to share of exports in output, in the previous period, confirming the idea that exporting accelerates the learning process in transition economies.

Furthermore, Hamar (2001) finds in her study of industrial networks in Hungary that the *“most export orientated firms have turned out to be the most dynamic in terms of output growth,”* (p15). She concludes that the improved performance of foreign owned firms is related to their increased export orientation, and in turn, this increased economic openness allows firms to benefit from improved product and market structure

Djankov and Hoekman (1996) find similar results for another transition economy, Bulgaria. Their econometric analysis shows that the re-orientation of export production to global markets¹³ is positively associated with total factor productivity growth. In addition, Clerides *et al.*, (1998) find evidence of learning by exporting in their study of exporting firms in Morocco¹⁴. In the case of the Moroccan apparel, leather and metal working sectors¹⁵ they find evidence of learning by exporting.

Aw and Hwang (1995) in their study of Taiwanese exporting firms find that there are significant differences in productivity levels between exporting and non exporting firms. They claim that the superior performance of exporting firms is due to their more efficient use of inputs, compared to domestically orientated firms, as they are subject to intense foreign competition¹⁶ (p330). Chibber and Majumdar (1999) also find evidence of learning by exporting in the case of Indian firms. They claim that firms which have higher levels of export

¹³ This is represented by a dummy variable equalling one if a firm has re-orientated its exports to the OECD and zero otherwise.

¹⁴ It should be noted that Clerides *et al.*, also study exporting firms in Mexico and Columbia, where they find little evidence of learning by exporting.

¹⁵ They measure this by the firm's average cost trajectory.

sales face greater competitive pressures, which means that they have to be efficient and provide high quality produce. Moreover, there are benefits to be obtained from operating in overseas markets, such as skills acquisition, which they conclude “*lead to superior performance as a whole,*” (p219). Their econometric evidence confirms this: export intensity is positively associated with return on sales and assets.

Delgado *et al.*, (2001) adopt a non parametric approach in order to examine the relationship between firm productivity and exporting in Spanish firms, during the period of 1991-96. They also find some evidence of learning by exporting. When they restrict their sample to firms which have only been in the market for a short time, they find that post entry (into export markets) productivity growth is greater for exporters, than non exporting firms. Although firms in this sample are not young in terms of existence, they are “young” in that they are inexperienced in exporting to the West, so learning by exporting may exist in transition economies.

Research by Bernard and Jensen (1999) examines the important issue of causality between exporting and performance in their panel data analysis of US manufacturing firms. They state that “*good firms become exporters*” as they are able to meet the additional costs involved in selling in foreign markets (p7). Their results confirm this: performance measures such as labour productivity, wages, and size are all higher ex ante for exporting firms. More importantly, they also find evidence of learning by exporting: exporting firms have a higher chance of survival, and greater employment growth, than non exporting firms.

However, Hitt *et al.*, (1997) document also that there are several costs of exporting. They state that although exporting brings new opportunities, it also presents increased competitive challenges. For example, they note that international diversification is complex and difficult to manage, and demands a great deal of managerial information processing, increased distribution and co-ordination costs (p772). This complexity is heightened by the presence of various trade laws and regulations. For example, Kogut (1985) emphasises the magnitude of these cultural and institutional barriers to international trade. In transition countries it is

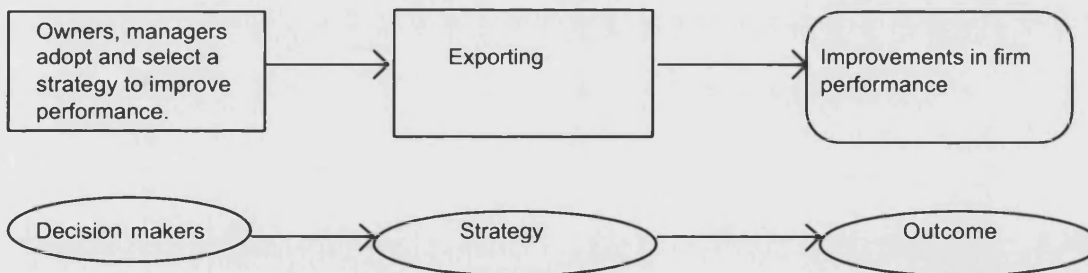
¹⁶ However their data is cross sectional, therefore we are unable to say if learning by exporting has occurred.

clear that these kind of barriers will be especially strong, given their previous trade regime under communism¹⁷.

More importantly, Hitt *et al.*, recommend that further research examines the ability of organisational structure to manage operations on international markets, a key focus of this chapter. Research by Roberts and Tybout (1997) examine the decision to export in firms in Columbia, and they have also included a dummy variable to control for ownership structure. However the contribution of this chapter will be to include a much wider selection of ownership variables.

Thus we have seen from the research mentioned above that exporting in many cases, brings certain benefits to the firm, and therefore owners or managers may use exporting as a strategy to improve performance (shown in the diagram below). When making this hypothesis we can employ the ownership-performance literature presented in the following section.

Diagram one: illustrating the analytical framework used in chapter five.



¹⁷ Bleaney *et al.*, (2000) note that under communism the relationships between customers and suppliers were different, as was the quality of produce. (p2)

5.2 OWNERSHIP, CORPORATE GOVERNANCE AND CONTROL IN THE WESTERN WORLD AND TRANSITION ECONOMIES.

The literature described below originates from Western schools of thought, however it may be relevant for the transition economies as the following issues are common to both environments: for example, the existence of agency costs.

However it is accepted that there may be some problems associated with applying Western literature to the transition environment. For example, in some countries a principal -principal situation (as opposed to principal- agent problem) could exist, in the case where there are conflicts between majority and minority shareholders. Furthermore literature pertaining to ownership concentration may not apply in some countries where the stock exchange and other financial institutions are not functioning properly, preventing shareholders from gaining large blocks of shares. Despite these drawbacks it is hoped that Western literature can offer some valuable insights along with a few of the recent studies concerning ownership in transition economies.

Milgrom and Roberts (1992) document that, *“the institution of ownership accompanied by secure property rights¹⁸ is the most common and effective institution for providing people with incentives to create, maintain and improve assets.”*

The theory of private property rights has three principal elements: the owner’s right to control assets, to transfer these assets, and enjoy the fruits of the assets. These private property rights create an alliance between owner’s rights to choose how to use his assets and the impact of the consequences of that choice.

Gravelle and Rees (1992) document that the system of property rights must be complete with perfect *excludability* and *transferability* (p514). This means that the property rights of a commodity must allow exclusion by one individual of all other individuals from the utilisation of the asset. This requires a legal environment which provides the individual with the ability to enforce this right of exclusion. Furthermore the property rights must be transferable, reflecting that the owner of the asset or good has the legal right to transfer use or ownership to any individual, on any terms.

¹⁸ Property rights are the rules (formal, legal or informal) which specify what individuals are allowed to do with resources and the output from these resources. *“Property rights define which of the technologically feasible economic decisions individuals are permitted to make,”* Gravelle and Rees, 1992, p10. Or, *“these (property) rights define the lines to which the assets may be put,”* *ibid*, p513.

Pejovich (1994) states that governments of transition economies need to recognise that the performance of all organisations depends on its system of prevailing property rights¹⁹, and the law of contract in which they operate. As a result governments must create and introduce a legal environment that would make a credible guarantee of the protection of property rights²⁰.

In the transition environment, the centrepiece of the transition to a market economy was the massive privatisation of the state sector (Pejovich, 1994), rather than the immediate concern for transferable and excludable property rights. Lieberman and Nellis (1995) claim that only *post* privatisation does the need for legal reform to protect property rights become essential and politically feasible. Consequently, Shleifer (1994) notes that property rights have been enforced by organised crime in Russia and many of the CIS countries, until a stable legal framework can replace this system.

The principal aim of privatisation was to transfer ownership from public to private hands, which will alter the relationship between management (*the agent*) and their *principal* (previously the government, and now replaced by an entrepreneur). This suggests a change in the relationship between those responsible for firms' decisions and the beneficiaries of its profits flows, arising in a new type of agency conflict. McFaul (1995) documents that agency problems existed previously in the Soviet era, between the State and the enterprise director.

In reality, the three option privatisation programme in Russia (see chapter 2 for an in depth description) mainly served the interests of the enterprise directors and prevented majority outside owners from gaining a majority. Managers could then purchase workers' shares or remain content with shares being dispersed widely among the workforce.

Dispersed ownership

Berle and Mean's (1932) seminal work highlight the dangers of dispersed ownership, which manifest themselves in divided control, absenteeism and free riding, as no shareholder has

¹⁹ Coase theorem states that if property rights are correctly defined and transaction costs are low, then economic agents will be forced to pay for any negative externalities they impose on others, and so market transactions will produce efficient outcomes. (Coase, 1960)

²⁰ It is well known that there are two schools of thought on effective corporate governance: the "market orientated" or "exit" and the "network orientated" or "voice" control mechanism (Moerland, 1998). The market orientated approach can be seen in the US or UK corporate governance regime, and the network based regime can be found in Germany and Japan. Although differences do exist (see Short *et al.*, 1997 for details), Shleifer and Vishny (1997) point out that both systems legally protect shareholders.

the incentive to monitor or control. As a result management may become entrenched and pursue objectives other than the profit maximisation of the firm, and instead maximise plough back returns to themselves. This can be contrasted with the situation discussed by Filatotchev and Mickiewicz (2001) whereby the concentration of cash flow rights in the hands of a large block shareholder lead to greater incentives to distribute dividends in a non distortionary way (p13).

Grossman and Hart (1988) highlight the dangers of individual small shareholders, claiming that monitoring of management will be limited due to free rider problems, and that small shareholders may find it optimal to vote with management and tend not to devote time to “*form an independent view*” (p201). Yet of course this depends on characteristics of the capital market, such as the protection of property rights (see for example, Shleifer and Vishny, 1997).

In Russia it was anticipated that managerial ownership would align their financial interests with the profits of the firm, as Demsetz and Lehn (1985) described in the Anglo-US environment.

However if no special monitoring arrangements exist then management may act opportunistically: this renders the role of corporate governance essential to align the interests of managers and decision makers with the interests of the owners.

McFaul (1995) shows that monitoring apparatus does not yet exist in Russia, for example managers are not disciplined by managerial labour markets, as they are not yet present in the Russian economy. In addition shareholder exit and discontent will not affect management as the stock market is not fully functioning. Estrin and Wright (1999) note that there is little threat of take-over in much of the FSU, due to the difficulty of purchasing shares. In short capital markets are very illiquid in the FSU with market capitalisation ratios reaching only 29.4% in Russia and 6.1% in the Ukraine, (EBRD, 1998).

Relational investors, such as investment funds could be expected to have certain informational advantages (explored further below) yet in Russia it is not sure that these institutions have superior information compared to citizens. Blasi *et al.*, (1997) show that mutual funds such as Asko Kapital and Promradtekhbank can negotiate with management to buy blocks of stock. In addition Black *et al.*, (1999) also paint a dismal picture of

investment funds, *"too often, they looted companies they invested in and were looted themselves,"* (p64).

Akerlof and Romer (1993) discuss other examples of looting in developing Latin American countries, along with the US, such as inflated net worth, riding the yield curve and acquisitions, development and construction loans.

They also study the financial crisis in Chile whereby an anticipated decrease in asset values stems from an expected depreciation in exchange rates.

In addition, they find evidence of looting of savings and loans in 1980's in the US. They claim that investments were designed to yield artificially high accounting profits and strategies implemented to pay large sums to firm officers and shareholders, eventually culminating in the crisis of the savings and loans sector (p23).

Managerial/insider ownership

The impact of managerial ownership has also been widely discussed in Western literature. The entrenchment hypothesis (Demsetz, 1983) states that insiders with greater equity enjoy an influence which allows them to guarantee their employment. This may produce decisions and strategies that are not consistent with corporate risk taking and enhancement of firm value and performance.

A study by Morck, Shleifer, and Vishny (1988) uses piece-wise regression to examine the non linear relationship between managerial ownership and market valuation, measured by Tobin's Q. The main results are that medium levels (5-25%) of managerial ownership are correlated with a fall in Tobin's Q and managerial entrenchment. Reasons for this could be that managers do not have the incentive to pursue value maximising or they maybe colluding with board members. However, low levels of managerial ownership (0-5%) are associated with increasing Tobin's Q, as managers may have incentives to maximise firm value in hope of promotion or the acquisition of more shares.

In addition, Wright *et al.*, (1996) also document a non-monotonic relationship, yet between insider ownership and corporate risk taking. They claim that at low levels of insider ownership, insiders are less likely to be entrenched and less prone to consume perquisites, due to fear of being discharged from their post. At higher levels of insider ownership, the relationship between insider equity and corporate risk taking is likely to be negative, as

insiders wealth becomes “undiversified.” This means that the majority of the insiders wealth is concentrated into a single investment, thus the insider may not want to increase risk taking with respect to that particular investment (p443). Bowles and Gintis (1993) also find that insider controlled firms have a “*tendency to engage in sub-optimal levels of risk taking,*” as members are not wealthy or compelled by outside interests to take risks.

In chapter two Jensen and Meckling’s (1976) model of the agency relationship was documented which examines the reduction of the market value of the firm associated with the owner manager’s consumption of perquisites. Their main result to note is that whenever ownership and control are separated *agency costs* occur due to the *self interested* behaviour of managers.

Yet, agency costs are balanced by benefits, as Fama and Jensen (1983) note in their seminal work. They show that the separation of decision management and control can contribute to firm’s survival via improved decision making by delegating decision functions to agents who have specialised knowledge, compared to many residual claimants, in addition to access to financial capital, which may be provided by outside owners.

In the transition context, Blasi *et al.*, (1997) show that in Russia the transfer of ownership to outsiders has been hampered, however if firms are to survive in the long run they must restructure, which will demand new capital investment. As political sources of capital in Russia, Ukraine and Belarus are drying up insider owned firms must begin to seek private sources of capital.

Jensen and Meckling (1976) develop a model which illustrates how insiders choose their optimal level of outside financing. This could be relevant for transition economies attempting to reach their optimal ownership structure, see chapter 2 for a full treatment of the model.

In more recent research Young *et al.*, (2001) find that the potential conflict does not concern the transfer of ownership to outsiders but problems between majority (principals) shareholders and minority shareholders (principals). They label this corporate governance problem the “*principal- principal problem*”. Thus in some cases the application of the classic principal-agent model may not apply.

5.3 The Insider/outsider ownership debate.

The mass privatisation of state owned enterprises during the period 1992-1994 led to the creation of manager controlled -employee owned firms, in CIS countries (Buck *et al.*, 2001).

Although the incidence of insider ownership is lower than it was in Russia, Ukraine and Belarus, from the tables below it can be seen that it is still rather high.

Table 1: Mean levels of inside ownership from 1994-1997 in sample used in this research (measured by average percentage of voting shares)

	1994	1996	1997
Russia			
Managerial ownership	11.5	15.4	16.3
Employee ownership	43.9	38.0	39.3
Total insider ownership	55.4	53.4	55.6
Belarus			
Managerial ownership	11.1	10.9	10.6
Employee ownership	56.8	50.8	43.9
Total insider ownership	67.9	61.7	54.5
Ukraine			
Managerial ownership	9.9	11.7	16.1
Employee ownership	63.6	43.5	36.5
Total insider ownership	73.5	55.2	52.6

Source: University of Nottingham database.

The table shows that insider ownership has fallen in Belarus and Ukraine, albeit the highest decline has been in Ukraine, however, managerial ownership has increased in Russia and Ukraine²¹.

Western literature and some studies of the developing world offer several views of the impact of insider ownership on firm performance, corporate risk and diversification.

Insider ownership, exporting viewed as corporate risk taking and firm performance.

One such study by Wright *et al.*, (1996) looks at the impact of equity ownership of corporate insiders upon firm risk taking. They define corporate risk taking as the analysis

²¹ The Blasi *et al.*, (1997) study mirrors this.

and selection of projects that have different uncertainties associated with their expected outcomes and cash flows.

The scope of this chapter looks at the effect of ownership on exporting behaviour, however exporting could be viewed as corporate risk taking: a strategy to improve performance. For example there are several costs associated with exporting, which may involve risk taking as anticipated profits from exporting may not always cover these costs (Roberts and Tybouts, 1997, p548). Furthermore, Chhibber and Majumdar (1999) find that exporting firms in India are likely to be “*more progressive and risk orientated,*” (p219).

Wright *et al.*, show that insiders may be influenced by three factors: their total wealth portfolio, pecuniary/non pecuniary benefits and costs and benefits derived from their position²². In the first instance, the undiversification of an insider’s wealth is concentrated in a single investment, this may cause the insider to avoid risk taking activities with respect to that investment. The presence of pecuniary/non pecuniary benefits and costs may also lead insiders to avoid risk taking, in order to prevent personal costs of risk taking, such as loss of employment.

Fama and Jensen (1983) postulate that insiders with higher equity are not fired for this behaviour as they have sufficient influence to guarantee their post, due to the *entrenchment effect*. Conversely, insiders with lower amounts of equity will be less prone to consume these benefits from their position as they are afraid of being fired.

Several analysts have argued that insider ownership can be beneficial, for example Jensen and Meckling (1976) maintain that with the existence of an effective corporate governance system, which would create an appropriate incentive structure, the interests of insiders and shareholders could be aligned, as their financial interests converge. Put more simply, by Gates (1998) “*people are likely to become better stewards of all those systems of which they are a part...as they gain a personal stake in the economic system, with the rights and responsibilities that implies,*” pp xix. Similarly Myron Scholes (1991) claims that inside ownership improves firm performance via two mechanisms. Firstly insiders are encouraged and have the ability to dispute managerial decisions they deem to be poor, and

²² These costs and benefits derived from an insiders position are analogous to Grossman and Hart’s (1988) *benefits of control*, such as perquisites.

secondly management become aware of this and the implications it has for monitoring, and thus strive to improve performance.

Ownership structure and meeting the costs of exporting.

The strategic management literature documents the costs of diversification Hitt *et al.*, (1997) (see analytical framework) and Kogut (1984) highlights the institutional costs to be overcome from exporting, which maybe hard to cover for employee owners, particularly in a transition environment. However, the economics literature also highlights *sunk* costs of exporting. Roberts and Tybout (1997) Clerides *et al.*, (1998) and Aw and Batra (1998) claim that entry into export markets involves sunk costs, in the form of costly investment in product quality upgrading, reputation and the creation of an exporting infrastructure.

In their study of the decision to export in Colombian firms, Roberts and Tybout (1997) find from their survey evidence, that Colombian producers attempting to sell in developed markets are often required to invest in product quality upgrading, and to acquire knowledge of an exporting infrastructure, to provide information on transportation, customs and shipping services. Clerides *et al.*, (1998) also give examples of sunk costs: the costs of *“researching foreign demand and competition, establish marketing channels, and adjustment for product characteristics and packaging to meet foreign tastes,”*.

A similar situation could also be anticipated in the former Soviet Union, as there is an absence of agents which deal with trading services, therefore we can expect firms to undergo considerable sunk costs to export from Russia, Ukraine and Belarus.

As we have seen, Wright *et al.*, (1996) postulates insiders may not want to undergo risk taking activities, as they base decisions *“solely upon an evaluation of personal gains and losses generated by a particular firm strategy,”* (p442).

The insider/outsider ownership debate in transition economies and less developed countries.

As for literature based on transition economies, Estrin and Wright (1999) claim that if outside owners possess ownership and control rather than managers, this will have a positive effect upon profits of the firm. Conversely insider ownership maybe prone to *“a reluctance to shed labour, slower restructuring, lower levels of investment and difficulties in obtaining access to capital,”* (p408).

Filatotchev *et al.*, (1999b) highlight that managers are prone to opportunistic behaviour and that entrenched managers will resist restructuring programmes. They suggest that management in Russian firms attempt to maintain insider control as it acts as an insurance against difficult restructuring decisions and protects income and employment. By using probit regression analysis they find that management entrenchment proxies are a significant determinant of management strategy focused at the preservation of insider control. In an exporting context Filatotchev *et al.*, (2000) find that ownership and control of management biases firms towards non exporting strategies.

Bim (1996) highlights several important interesting facets of ownership structure in Russia which may prove relevant for the following hypotheses. From his survey he finds that managers have strengthened their positions at the firm level, and none of the directors interviewed expressed problems concerning a lack of autonomy. In Bim's sample employees maintained that managers were in complete control of enterprises in 80% of cases in 1994.

Bim then reflects upon the consequences of this "*managerialism in Russia*" or the concentration of ownership in the hands of managers and concludes that there are two contrasting types of managerial strategy. Optimistically there is the "*constructive*" strategy whereby managers attempt to adapt the enterprise, involving the restructuring of the product mix, supply chains, and improving intra firm organisation. Bim found that approximately 26-28% of managers followed this strategy. The second strategy is termed as "*destructive*" which Bim finds to be the dominant strategy among 60% of the managers interviewed. In this case managers do not try to adapt and restructure their enterprises but extract income for their personal gain.

More generally, Akerlof and Romer (1993) note that bankruptcy for profit is likely to occur in environments where poor accounting and regulation exist or low penalties for abuse give owners the incentive to pay themselves more than their firm's worth and then default on their debt obligations. This type of economic underground can flourish "*if firms have an incentive to go for broke for profit at society's expense (to loot) instead of to go for broke (to gamble on success)*" (p2). This presents an environment highly applicable to that of many transition economies. As a result bankruptcy for profit can become a more attractive strategy for owners rather than to maximise true economic values. Thus owners

attempt to maximise current extractable values, not economic value, causing social losses. Therefore bankruptcy for profit is known as “looting”, (p3).

Gurkov and Asselbergs (1995) document the disconnection of ownership and control in their survey of Russian firms, and show that the distribution of shares does not conform to the real structure of control. In their sample employees hold more than 51% of shares in eight companies yet only 17% believe themselves to be the real owner, while 75% of workers claim that the real owners are the general director and his top managers.

Similarly, Filatotchev *et al.*, (1999) find from their survey that “ownership per se is not synonymous with control,” (p1028), particularly in Russia, compared to Ukraine and Belarus.

Bim also emphasises the role of outside owners in corporate governance in Russian private companies. He makes several observations, firstly that those outsiders without a “sizeable” stake will be unable to advance enterprise performance, while those enterprises dominated and controlled by outsiders have implemented restructuring programmes, however in some cases outside ownership has been associated with “company raiding.” (See Gurkov, and Earle and Leshenko, 1995).

Blasi *et al.*, (1997) also documents the delay of the transfer of shares from insiders to outsiders. Yet by 1996 outside ownership had begun to increase and on average they owned 32% of shares, however this type of ownership is believed to be concentrated in a small number of firms. The effect of this outside ownership on financial conditions of firms is negligible, reports Blasi²³, yet it is found to influence positively the level of exports and downsizing (p69), this will shape the subsequent hypotheses.

However, we can expect the objective of outside owners to be the maximisation of the long run value of the firm, yet their ability to restructure depends on their control rights within the firm and their access to finance and capital (EBRD, Transition Report, 1995). Restructuring is influenced by several forces: the aims of the owner of the firm and the distribution of control rights²⁴. The Transition Report (1995) confirms the suggestions of economic

²³ Estrin and Wright (1999) also state that economic performance is not influenced by ownership structure or their dynamics.

²⁴ As well as the availability of new funding and budget constraints, EBRD, 1995.

analysis, restructuring other than reactive, requires capital and occurs in firms with outside ownership, with access to finance²⁵.

Bhavani and Tendulkar (2001) use the form of business organisation as a proxy for access to capital and the ability to raise finance, which they adopt as a determinant of export intensity and propensity, in their study of Indian textile firms. Similarly, we have sufficient evidence to assume that inside owners do not have sufficient access to capital in the FSU²⁶. For example, Aukutsionek *et al.*, (1998) find in the Russian case that most managers cannot secure capital to modernise (p123) and Estrin and Wright (1999) find that insider owners also have difficulties gaining access to capital. One of the reasons for this is that in 1995 the government ended its position as a source of lending to companies, meaning that firms now had to compete for bank loans, also banks only wanted to be involved with short term loans and small projects, as they were wary of the risk of lending to enterprises. This was exacerbated by the fact that there was a trend for banks to lend to the government, leaving firms “starved for capital,” (Blasi *et al.*, 1997, p143). Therefore we can expect insider ownership to be negatively associated with exporting, especially when we consider the sunk costs of exporting to be covered, mentioned above.

For example Craig and Pencavel (1995) document why insider controlled firms²⁷ have difficulty in raising capital and why the cost of capital is so high for them. Firstly, these firms are deemed as “*risky institutions*” (p126) as workers wealth is undiversified, and they have little access to collateral, which can be forfeited in the event of the inability to meet repayments. Secondly lenders, such a banks or credit institutions are not allowed much say in what the insider controlled firm does, as the board of directors has much more involvement in day to day business, than in conventional firms (p128). Furthermore a moral hazard²⁸ problem exists as the actions and decisions of the insider controlled firm will affect

²⁵ Their study of ownership and restructuring in Hungary, Poland and the Czech Republic shows that restructuring is greater in firms with most outside ownership.

²⁶ For example, the Transition Report (1998) documents that there has been a “*significant under provision of loans to the private sector,*” (p127), as many banks in the region do not have the opportunity or incentive to expand its loan portfolio. Also many banks are hindered by macroeconomic instability or general problems with the transition process. These institutional factors may prevent firms from exporting as they do not have access to funds to cover the sunk costs of exporting.

²⁷ Craig and Pencavel (1995) use data from an unbalanced panel of 34 firms in the plywood industry in the US during the period 1968-1986.

²⁸ Moral hazard occurs when the actions of an insured agent can alter the accident probability, and those actions are not observable by the insurer. (Gravelle and Rees, p672, 1992).

the probability of defaulting on repayments, but their actions will not be visible to the bank, or lender. Bowles and Gintis (1993) also note that “*democratic firms*”²⁹ operate at a competitive disadvantage, as they face higher capital costs due to agency problems in capital markets and the limited wealth of their workers. Furthermore, a lack of capital prevents them from borrowing funds from banks, which they deem the “*wealth in equality constraint*”.

Thus raising capital in the former Soviet Union maybe troublesome considering the extent of insider ownership.

Jones and Mygind (1999) find that insider ownership may bring other problems: it is often associated with strategic inertia, thus we can expect a negative impact upon trade re-orientation.

Finally, Filatotchev *et al.*, (1999) note that managerial entrenchment may prove to be an obstacle to export promoting strategies and results show that managerial ownership is negatively associated with exporting, in previous research using this database. Therefore **H1: inside owners may have reason to block exporting strategy and thus lagged insider ownership shall be negatively associated with exporting levels, shall be tested.**

Throughout this research export intensity shall be treated as the percentage of sales which *go beyond the FSU*, as we can expect that exports to the former CMEA utilise former distribution networks³⁰ etc. (see Filatotchev *et al.*, 2001b).

Given the results previously found by Blasi *et al.*, (1997) concerning the effects of outside ownership on exporting in Russia, and the fact that ownership could be used as a proxy for access to capital, and a firm’s ability to raise finance (Bhavani and Tendulkar, 2001³¹), we

²⁹ These are firms which are owned and run by their workers.

³⁰ Estrin (2001) states that although Russia and Ukraine exported a large share of their GDP, it was mostly within the CMEA trading arrangement, for example, 64% of Russia’s exports were within the CMEA, while the figure stands at 82% of Ukraine. This is an indicator of their “*market interconnectedness*” (p6).

³¹ They argue that the form of business organisation may reflect a firm’s ability to access capital in their study of Indian export performance. They represent a firm’s business organisation with three types of dummy variables (p71).

can expect outsider owners to have greater access to capital, which will allow them to cover the initial costs of exporting.

In addition, Filatotchev *et al.*, (2001) note that outsider control can have a positive effect on corporate restructuring, which could include export orientation, and Djankov and Murrell (2002) conclude in their exhaustive literature review that outsider owners have the largest effects on restructuring in central and Eastern Europe and CIS countries.

Thus **H2** is developed.

H2: lagged outside ownership shall be positively associated with exporting.

Foreign ownership

In previous research it has been hypothesised that foreign ownership has a powerful effect on the exporting activity of firms.

The classic text by Caves (1996) highlights that foreign ownership is determined by a desire to market seek or export extensively (termed foreign sourcing) (p215). Firstly, market seeking can be defined as a foreign owner wishing to serve and take advantage of a domestic market; given the relatively large domestic market of Russia, this may be a vital incentive for foreign investors. Alternatively, foreign owners may wish to engage in export processing or foreign sourcing activities, whereby raw materials or part manufactured goods are exported, and then re-exported after additional processing.

Molero (2001) in his study of Spanish firms tests whether foreign ownership attracted to the host country for reasons of foreign sourcing. He finds that it is common for foreign owned firms to adopt the strategy of using the host country as an export platform (p41), and in some cases exports are at least as important as domestic sales.

Empirical evidence from transition economies and less developed economies has shown that foreign sourcing has been a strong incentive for foreign ownership. For example, Willmore (1992) has found that among Brazilian firms "*foreign ownership ...has a very strong, positive independent effect on export performance,*" (p333). The reason for this relationship is that transnational enterprises have links to other countries, therefore it may be advantageous for firms to exploit these links and export to these countries (p315).

McMillan (1993) makes a similar hypothesis concerning foreign ownership and foreign trade in transition economies. He proposes that foreign investment can help to channel capital to

firms and industries that are capable of competing in an international sphere, thus foreign ownership can assist the long term expansion of trade (p111).

Konings (1999) states that firms with some foreign ownership have enhanced access to technological know how and finance, which is necessary to update equipment and bring about strategic restructuring, of which exporting is an element. Furthermore he states that foreign participation in domestic firms can impose an efficient corporate governance system on insiders in privatised firms. Using a large data set on Polish, Bulgarian and Romanian firms Konings finds evidence that foreign firms induce restructuring, which results in a variety of performance benefits, such as higher productivity. In addition, Rojec *et al.*, (2000) find that in the case of Slovenia foreign firms are more likely to export a larger proportion of their output, than majority domestically owned firms.

In his book "*Trade and Transition*" Alasdair MacBean (2000) summarises some of the main results from his research project, for example, Sass finds that in Hungary 80% of exports are accounted for by foreign owned companies. Again, this motivation for exporting, is similar to that found by Willmore. Companies with foreign participation often have close links with a foreign company, which develops its trade relations, alternatively it may be able to trade with affiliates of the controlling foreign company. Furthermore, MacBean concludes that in the transition economies the output of foreign owned firms is very export orientated, he quotes the case of the Czech Republic where Volkswagen Skoda is the largest exporter of machinery and transport goods. As for the export success of much of Eastern Asia, this can also be largely contributed to foreign ownership and joint ventures. Thus we can anticipate that foreign ownership in the former Soviet Union will also have a positive effect upon exporting activity.

Furthermore, Bhavani and Tendulkar (2001) suggest that foreign owners may have greater access to capital to cover the costs of exporting, by assuming that ownership or the form of business organisation is a proxy for access to capital.

In order to test whether foreign ownership is motivated by foreign sourcing we shall test **H3: lagged foreign ownership shall be positively associated with exports**

State ownership

The extent of state ownership could also be expected to affect export activity in a transition environment, note Buck *et al.*, (2000). They note that state ownership may negatively affect productivity and in turn exporting activity, on the other hand state involvement may provide access to soft credits and export licenses, which would increase exports. The Buck (2000) study uses a continuous variable to represent state ownership, in this study a dummy variable shall be constructed, equalling one if a firm has experienced a decline in state ownership and zero otherwise, in order to test

H4: a decline in state ownership in year Y_{t-1} will lead to an increase in exporting activity in year Y .

The reason for this dummy variable being used is that state ownership over the period 1994–1997 has not declined dramatically³², as a result we can expect that a *decline* in state ownership will have a more dramatic impact on firm strategy, as this could represent more freedom from bureaucratic control and an absence of preferential export credits. Therefore a dummy variable is used to represent a decline in state ownership, as opposed to the absolute level represented by a continuous variable.

5.4 Board structure and stake in equity

A further issue identified in the western literature is board structure. For example, Drucker (1981) highlights that the compositional characteristics of boards can influence organisational performance. We can expect board structure to be a determinant of exporting as the board's function is to manage the business and affairs of the corporation, Klein (1998). Moreover, Daily and Dalton (1994) postulate that a company's board structure, characteristics and processes can influence a firm's strategic choice and organisational outcome. Secondly Hermalin and Wesibach (2000) also highlight the importance of the board in stating, "*boards of directors are an economic institution that helps solve the agency problems inherent in managing any organisation,*" (p1). In particular, the firm's board of directors may contribute to its corporate governance system by selecting and monitoring the CEO. Moreover it can influence the firm's strategy

³² In 1994 the percentage of voting shares held by the state, in this sample (for all three countries) was 13.5%, in 1997 it had only fallen to 11%.

and general setting and evaluation of firm productivity. Thus we can expect that board structure will affect the level of export activity, and the decision to export.

The role of insiders, outsiders and bankers on boards.

Wagner *et al.*, (1998) document that researchers have determined several roles for boards of directors. Those working under the resource dependence perspective (see Pfeffer and Salancik, 1978) claim that outside directors (those who are not current or former employees) can facilitate the acquisition of resources and share their breadth of knowledge to enhance firm performance. Furthermore, those working under the auspices of the agency framework claim that outside directors can reduce managerial opportunism and thus boost firm performance (p656).

Kroszner and Strahan (2001) research the special case of having a banker as a member of the board, this may be relevant as a variable is used in this chapter, which represents the number of seats held by outsiders, in which bankers are included. Their research documents the benefits of having a banker on the board. For example, they state that a close bank relationship “*can improve information flow between the bank and the firm*” (p419). This can assist the firm in obtaining finance from the bank, which can lower the cost of external financing. Also if a banker joins the board of a firm it may act as a signal to the market that the firm is unlikely to suffer from financial distress.

Lastly, Kroszner and Strahan note that bankers on boards may bring greater rewards to “*more volatile firms*”, with information asymmetry problems, this maybe especially pertinent for firms in the former Soviet Union³³.

However, some researchers propose that insider directors have specialised knowledge and expertise about their organisation, which can be used to promote performance (Baysinger and Hoskisson, 1990).

Using a meta analysis of 29 studies Wagner *et al.* attempt to find empirical evidence of these proposals. They find that greater levels of insider *or* outsider presence are both positively related to superior levels of organisational performance, supporting the hypothesis of homogeneity of board structure, which states that greater numerical superiority allows either

insiders or outsiders to make use of their relevant strengths and develop extra organisational connections (p667). This can be expected to lead to higher levels of social integration and cohesion and a reduction in the tendency for inter group conflict (Hambrick and Mason, 1984). Upper echelon researchers have then continued to show that this homogeneity effect can lead to superior organisational performance.

Wagner *et al.*, then test this homogeneity hypothesis with a sample of 301 firms in the US, during the period of 1990-4. They find support for the homogeneity effect: both insider and outsider directors can be expected to positively affect firm performance (measured by return on assets).

Board structure and performance³⁴

A study by Vance (1983) uses data from 250 manufacturing firms in the US and provides results that would suggest that firms with a majority of insider directors have superior performance compared to firms which possess a board with a majority of outsiders, as *"directors who have a financial stake in a company are unlikely to dash their own cash,"* (1983, p.274).

Agency theorists (such as Hoskisson and Baysinger) also highlight the advantages of having a board structure characterised by insider directors. Insider directors may provide an efficient internal monitoring system, and act as an invaluable source of information concerning the activities and achievements of the CEO. However we will see below that inside directors are not immune from the powers and authority of the CEO.

In contrast, some researchers have claimed that inside directors may make inefficient monitors, Goforth (1994)³⁵ shows that directors are often selected by their willingness to support managerial decisions. It is not surprising that these directors feel awkward when evaluating the performance of CEO and TMT (top management team), their loyalty to the CEO and fear of possible retaliation may prevent them from monitoring efficiently. However, Baysinger and Hoskisson, (1990) also document that inside directors may provide superior information to outside directors, as they do not have to rely only upon financial data of CEO

³³ However, Kroszner and Strahan (2001) also note that there can be *"significant costs of active bank involvement in firm management,"* (p420), as bankers may suffer from a conflict of interest between fiduciary duty to a firms owners' and to his or her bank employer, if the bank also lends to the firm.

³⁴ Of course it is accepted that firm performance may affect board composition, see Hermalin and Wesibach (1988) for an endogenous treatment of board structure.

attainment, also they are bared to the workings of the firm on a daily basis, and do not suffer from criticisms of outside directors, who are often directors of other boards, or act as a CEO, which puts pressure on their time to monitor successfully other firms' CEO's.

Nevertheless, outside directors³⁶ are claimed by some researchers to be more efficient monitors than insider directors. By being an outside director these board members render themselves independent of the CEO.

Yet, outside director's independence has often been questioned, these directors may have personal or professional links with the firms or its management. For example, if they play a legal or consulting role within the firm, they may be under obligation to the CEO, note Johnson *et al.*, (1996). Other affiliated directors such as clients or suppliers may also be unwilling to question CEO behaviour or performance if they fear the severance of their economic relationship.

On the whole, it seems that the role of the outsider as a potential monitor of managerial performance and provider of a diverse knowledge base is undeniable, which can be of use for the formulation of strategy.

Klein (1997) refutes the relationship between firm performance and board structure, yet she does find a relationship between performance and committee composition. By examining the role of director via participation on board committees (such as finance, strategic development and long term investment) she claims that internal management contribute valuable specific information about the organisation and that outside directors can provide effective monitoring for firms with strategic difficulties. Her results show a significant and positive relationship between the percentage of insider directors on financial and investment committees and accounting and stock market performance. Thus participation in board committees could be a source of further research, as opposed to general board composition.

³⁵ See Goforth, C, "Proxy reform as a means of increasing shareholder participation in corporate governance: too little but not too late," *The American University Law Review*, Vol.43, pp379-465.

³⁶ Classified as all non management members of the board (Daily and Dalton, 1992)

The role of the board in times of financial distress: an application to transition economies.

Perhaps more relevant to the transition economies is the research pertaining to board composition and the firm's ability to overcome financial distress. For example, Filatotchev and Bishop (2001) note that when an organisation encounters uncertain environmental conditions a board of directors may provide an important strategic contribution by formulating and developing the firm's strategy and mission plan.

Given that the majority of industrial companies in the three countries at question here have suffered from severe industrial decline the configuration of the board may prove important in inaugurating a successful turnaround. For example, outside directors with affiliations to financial institutions may prevent or cure financial distress, if they can provide access to loans and consultancy. Stearns and Mizruchi (1988) provide evidence of this: firms appear to appoint directors from financial institutions at times when profit and solvency are in decline.

On a more general note Pearce and Zahra (1992) show that board composition is determined by environmental uncertainty, firm strategy and financial performance.

Thus we should expect some changes in board structure in the FSU over the period of industrial decline.

Presently, in the Russian case, insiders dominate boards, and usually are more similar to a management council, comprising the general manager, his senior staff, plus possibly a representative of local government, documents Blasi, *et al.*, (1997). Consequently, although outsiders hold a certain level of stock, they have been denied seats on the board, and are not allowed to be involved in decision making activities, (see p202, Blasi, for an overview of the discrepancy between ownership and board representation).

The details of board structure for the sample used in this study are shown below, for 1994-

7. Again board seats are concentrated in the hands of managers or workers in all three countries, and also foreign companies are very poorly represented. In the Russian sample the maximum number of seats held by a foreign company is one, for Belarus zero, and Ukraine, three.

Table 2: Average number of seats held by the following members on the Supervisory Board

	1994	1996	1997
Russia			
Managers	3.3	3.2	4.8
Investment funds	0.2	0.4	0.7
Belarus			
Managers	4.6	4.1	3.9
Investment funds	0.0	0.0	0.1
Ukraine			
Managers	5.3	4.4	6.0
Investment funds	0.3	0.3	0.2

Source: University of Nottingham database. Also see C4 for more descriptive statistics on board structure.

From this section the following hypotheses are arrived at:

As we can expect insider directors within the transition environment do not have access to resources and consultancy services, therefore we shall test **H5, H6, and H7**.

H5: lagged board representation of insiders can negatively affect exports in representing the entrenchment hypothesis.

H6: lagged board representation of outsiders can positively affect exports representing resource dependence roles.

H7: lagged board representation of foreign owners can positively affect exports.

Following this, an interaction variable representing outsider control³⁷ shall be constructed allowing us to test

H8: the lagged interaction of outside share holding and percentage of board seats held by outsiders can be expected to have a positive affect upon exports.

5.4B MANAGERIAL TURNOVER

In the transition milieu it is becoming evident that outside ownership may not be enough to provide the correct incentives for managers to improve performance, document Estrin and Wright (1999); instead, existing management may need to be replaced. New managers may provide the skills and resources necessary for restructuring.

In the Western literature, Lausten (2002) in his study of CEO turnover and firm

³⁷ Defined as the percentage of seats held by outsiders* percentage of voting shares held by outsiders.

performance in Danish firms, notes that principal agent theory predicts that the threat³⁸ of turnover encourages the CEO to do his best (p395). This draws from pay-performance literature, based on agency theories on optimal and incentive contracting, which claims that CEO turnover acts as an incentive to force the CEO to act in the interest of the share-holder. As a result, the threat of dismissal for poor performance acts as an incentive to CEOs. Lausten goes on to test the hypothesis that the relationship between CEO turnover and performance is negative. His results from a longitudinal database confirm this: poor performance is positively and significantly related to CEO turnover, being consistent with principal-agent theory, in that the threat of turnover ensures that CEOs act in the best interests of the shareholder. (See Jensen and Murphy, 1990, and Rosen, 1992 for more empirical evidence.)

In contrast, researchers studying the former Soviet Union find that turnover precedes performance³⁹. Barberis (1996) found that managerial turnover improved enterprise performance in Russia, later Filatotchev *et al.*, (1999) note that former “Red Directors” are unable to implement restructuring programmes, thus CEO replacement maybe required. In the case of Ukraine Warzynski (2001) finds that managerial turnover boosts productivity in privatised enterprises. More recently, Filatotchev *et al.*, (2001b) note that top management inertia and resistance to change is common. Similarly, Ocasio (1994) noted that a change in the top management team led to an increase in the probability of a change in organisational strategy. Thus this leads to the development of the next hypothesis,

H9: a change in directorate can be expected to positively affect exporting.

5.5 Ownership concentration

Filatotchev and Mickiewicz (2001) document several roles for large block-holders, some being value enhancing and some being value detracting. This section shall attempt to describe these roles, particularly in an environment where the protection of minority shareholders is low.

³⁸ The threat of replacement may induce changes in managerial performance akin to actual managerial replacement.

³⁹ Harrison (1988) noted the causality problem between the relationship between performance and top management turnover, and stated that there is no general theory of turnover as yet.

Above we saw that in the presence of free riding by small dispersed shareholders as discussed by Grossman and Hart (1988), ownership concentration may evolve, in order to overcome principal-agent problems.

La Porta *et al.*, (1999) document that widely dispersed ownership described by Berle and Means is only common for organisations in wealthy countries with common law, and effective legal protection. La Porta *et al.*, find that ownership concentration is common where legal protection is poor for minority shareholders from their study of 27 wealthy economies.

Ownership concentration, firm performance and monitoring.

Demsetz and Lehn (1985) focused upon the determinants of ownership concentration in some 511 US firms. They argue that the larger is the firm size, *ceteris paribus*, the larger is the firm's capital resources and in general, this gives rise to a greater market value of a given fraction of ownership. Thus "*the higher price of a given fraction of the firm should, in itself, reduce the degree to which ownership is concentrated,*" (p1158). This implies that firm size and ownership concentration shall be negatively related. Since the firms included in this study are medium or large, size should be controlled for when examining the impact of ownership concentration. In addition they claim that a firm's environment will effect control potential⁴⁰, for instance market stability, where prices, market shares and technology are stable allow management to be monitored at a relatively low cost, the need for tighter control and concentration is reduced. The firm's environment in the three countries of this study, Russia, Ukraine and Belarus, is much less stable and characterised by industrial decline thus we can expect managerial performance to be difficult to monitor, leading to a higher degree of concentration.

Demsetz and Lehn then continued to test the Berle and Means hypothesis which states that ownership concentration and profit rate should be positively associated. However, their empirical results show that there is no significant relationship between ownership concentration and accounting profit rate, in fact the sign on the concentration coefficient is negative.

⁴⁰ Control potential is defined as "*the wealth gain achievable through more effective monitoring of managerial performance,*" p1158.

Similarly, Thomsen and Pedersen (1996) find no relation between ownership concentration and company performance.

In contrast, a study by Bethel and Liebeskind (1993) confirms agency predictions that block-holders exert a disciplinary effect upon management. From a sample of firms in the 1980's that had undertaken corporate restructuring they find that block holders act as a disciplining influence upon managers and attempt to support the goals of the other shareholders, as opposed to the goals of the management team.

Other studies from the Western literature focus on the relationship between ownership concentration, firm performance and firm value.

Shleifer and Vishny (1986) develop a model focusing on the role and influence of large shareholders on performance. Their detailed analysis using comparative statics, shows that large shareholders raise expected profits, and the more so the greater the percentage of ownership (p465).

Wruck (1989) posits that a greater level of ownership concentration may have two opposing effects upon firm value. The relationship may be positive when a blockholder uses his power to ensure that corporate resources are governed efficiently. In this case the concentrated owner will have the incentive to reduce shirking or free riding, and thus will be willing to undergo the costs of monitoring, in order to enhance firm performance.

Nevertheless, Wruck finds that blockholders may have a negative effect upon firm value in some cases. Blockholders may not always use their votes to see that corporate resources are managed effectively, instead they may entrench managers and insulate them from market discipline (p12 and 15), creating "*impediments to the alignment of interests*" (p23). Her final results examining the relationship between ownership concentration and firm value, using a sample of US firms, find that the effect of concentration on firm value is "*positive on average*" (p23).

The evolution of ownership concentration in transition economies. Evidence of a possible relationship with performance?

In the case of transition economies, Blasi *et al.*, (1997) document that open trading of stock and independent shareholder registers are not particularly common in Russia, which may hinder stock holders from acquiring a block of shares. Without an active regional stock

market blockholders who wish to increase their stake must apply directly to management to identify other shareholders, additionally the stock market is still nascent with only 20-50 of the largest companies being traded, these environment specific factors may hinder concentration (see Filatotchev and Mickiewicz, 2001 and the next page for more on this). Estrin (2001) documents that the lack of concentrated ownership in Russia has been caused by the nature of the privatisation process, as voucher privatisation leads to dispersed ownership structures (p14).

Furthermore Blasi, *et al.*, (1997) points out that it may not be enough to be a blockholder in order to initiate change to management or capital investment as the use of cumulative voting is ignored, thus ownership stakes are not translated into the appropriate number of seats on the board. As a result only 5% of firms in Russia are majority owned by several blockholders (p206, Blasi *et al.*, 1997). Frydman *et al.*, (1993) note that the presence of blockholders has been allowed by the privatisation programme, yet they face the “*formidable power of the manager,*” (p187) owing to the prevailing dominance of insider ownership in Russia.

Frydman *et al.*, (1997) claim that the privatisation programme in central and East European countries led to very highly concentrated levels of ownership, as owners cannot rely on institutions and arrangements to monitor managerial performance. In their study of Hungary, Czech Republic and Poland they incorporate a dummy variable which identifies the largest owners of the firm, a similar methodology shall be used in this chapter.

More importantly, the transition literature also identifies that a relationship exists between company performance and ownership concentration.

A study by Aukutsionek *et al.*, (1998) provides evidence that Russian privatised firms which are dominated by outsiders and managers exhibit superior performance compared with those firms dominated by employees.

Andreyeva and Dean (2001) test the hypothesis that company performance in Ukraine improves with ownership concentration, and moreover that concentrated insider owned firms perform better than their outsider counterparts. Using a sample of 1170 open joint stock companies they find evidence of a positive relationship between concentrated private ownership and company performance (measured as sales per employee). Furthermore the identity of the concentrated owner is of importance: “*insider owned firms perform the*

best” (p524). The reason for this may lie with the persistence of institutions and informal norms inherited from the Soviet era within the Ukrainian economy. Outsiders may not know or want to adhere to non market practices, whereas existing managers have personal connections and experience of the political elite⁴¹.

In a study of 85 Russian firms Filatotchev *et al.*, (2001) find that there is a negative relationship between ownership concentration and firm performance and investment (p310). However, this relationship is not affected by the identity of the shareholders, in contrast to the findings of Andreyeva and Dean (2001). They suggest that the reason for this negative relationship is that the entrenchment effect of concentrated ownership is stronger than the incentive effect, in an environment where minority shareholders’ rights are not protected. Previous research by La Porta *et al.*, (2000) has also indicated that concentrated ownership produces a trade off between incentives and entrenchment.

Regulation, institutional and legal environments.

Regulation has been identified as another factor that will impact on concentration. Following the view that regulation may provide some “*subsidised monitoring*” of management, it is anticipated that regulation should reduce the need for ownership concentration. Considering that the regulatory framework is viewed as poor in the FSU it is possible that incentives for ownership concentration will be high, despite the privatisation process leading to dispersed ownership initially. For instance, after privatisation, fundamental institutions to monitor management and controlling stockholders did not exist. Black *et al.*, (1994), state that by 1994 a Securities Commission had been created, but lacked funds and political leverage to investigate seriously any claims of misdemeanours.

Lastly, “*amenity potential*” of a firm’s output is also likely to affect ownership concentration. Some industries are more prone to amenity consumption⁴², and some are more prone to the reigns of tight control, and this will in turn lead to a higher degree of concentration.

In the example of the FSU it has been documented that managers have had the occasion to consume amenities, thus ownership concentration can be expected. For example, Fox and

⁴¹ Of course self selection may occur with insiders selecting ownership of better performing firms.

Heller (1999) document a case where a director of an oil company was skimming 30 cents per dollar of revenue, thus destroying the value of minority shares in the company. Black (1999) claims that insiders such as managers and controlling shareholders often engage in “*inside dealing*” and asset stripping, which is exacerbated by an unfriendly business milieu. Lieberman and Nellis (1995) cite that in Russia outsider shareholders have difficulty exercising minority rights, even obtaining information, contacting fellow shareholders and voting their shares is troublesome. When outsiders have tried to exercise control, insiders have employed various extra-legal methods to prevent them, thus ownership concentration can be expected.

However we have seen above that a tendency for concentration may not occur in transition economies, due to a poorly functioning, illiquid capital market. Also insiders may be prone to block this concentration of ownership. Fox and Heller (1999) identify poor corporate governance practices occurring in Russia, one of them being non pro rata distributions, whereby firms fail to prevent diversion of claims, often by diluting shares held by outside minority share holders.

Filatovchev and Mickiewicz (2001) state that in a transition context results concerning ownership and performance are conditional on institutional and legal environments. For example, dominant shareholders may be more likely to monitor management and exercise their voice function in a poorly defined, weak legal environment. However, Filatovchev and Mickiewicz (2001) highlight that the actions of dominant owners may be detrimental to minority shareholders, given the poor legal protection of these shareholders in central and Eastern Europe.

A study by Gurkov and Asselbergs (1995) show that outsider blockholders, (from a survey of 27 privatised Russian firms) do not always seek to invest and improve firm performance in the long term. Bim (1996) suggests that the cause of this is the very nature of these outsiders, for example some domestic investors may be associated with “mafiosi” structures, causing contamination in the behaviour of businesses, while some foreign owners may be

⁴² Defined as the utility consequences of being able to influence the type of goods produced by the firm, p1161.

from “marginal” companies, (p493)⁴³. Lastly, Blasi *et al.*, (1997) states that blockholders are not effective at bringing capital to firms (p148).

Data considerations.

Thus, it will be hypothesised that the presence and identity of a dominant shareholder will affect the level of export activity, as it is assumed in this chapter that exporting is a strategy undertaken to improve firm performance. The aforementioned studies have focused upon concentration and firm performance, however here it is assumed that exporting is a strategy to improve performance (see the analytical framework.).

Since the dataset used in this study does not allow the calculation of ownership concentration, as the percentage of share ownership of the largest shareholder is not included, the presence of and identity of a group of dominant owners shall be used⁴⁴. In fact, this may be useful as the level of ownership concentration is low in Russia (Blasi *et al.*, 1997, p206).

Although a major shortfall of this chapter is the absence of a direct measure of ownership concentration, it will be illuminating to see whether the presence of a *group* of dominant owners and their identity have a similar effect on exporting activity. Furthermore, one of the contributions of this study will be to determine whether *groups* of concentrated owners behave in a similar fashion to a single concentrated owner. It may be found that groups of concentrated owners co-operate in order to form export orientated strategies, and thus improve firm performance. In any case, the role of coalitions between large blockholders is recommended as a line for further research (see Filatotchev *et al.*, 2001). For example, Dyck (2000) suggests that multiple blockholders maybe efficient in environment where legal protection is poor.

The reason for including the presence of dominant owners stems from agency theory, having seen that dispersed ownership does not allow the direct monitoring of management, we can expect that dominant shareholders will be more active in the monitoring of managerial behaviour. The identity of the dominant shareholder may also effect the degree of monitoring

⁴³ Foreign investors in Russia are not always from the best Western companies, but from those based on activities of former exiles where domestic capital is illegally exported, these are “marginal companies”.

carried out. For example a dominant owner which is a financial institution may suffer from the problems being associated with being a “*pressure sensitive investor*” or in contrast it maybe “*pressure resistant*” and fully undertake monitoring behaviour. A pressure sensitive investor is likely to be influenced by management, whereas its counterpart, a pressure resistant investor does not enjoy a business relationship with the firm and is able to exercise voice over the firms’ actions. (see Kochhar and David, 1996 for further details and below, where this is explored in the following section).

Thus, in order to test if a group of dominant owners act as superior monitors of managerial behaviour and are able to implementing performance enhancing strategies such as exporting we have **H10: the presence of a dominant owner in year Y_{t-1} shall positively affect exports in year Y .**

In order to test if the identity of this group of dominant owners affects exporting we have the following hypothesis **H11**, by creating an identity variable, to represent if the group is dominated by outsiders.

H11: the presence of an outside dominant owner in year Y_{t-1} shall positively affect exports in year Y , as we can expect these kind of dominant owners to have more power and incentive to become involved in restructuring.

5.6 Institutional owners

In recent years institutional investors have become important players in capital markets⁴⁵. By referring to several studies in the literature we can note that these types of investors may have a role to play in the restructuring in the firms in transition economies.

The role of institutional owners in the developed world.

Prowse (1990) documents that in Japan financial institutions take large positions in debt and equity of the same firm. He shows that when financial institutions are allowed to be leading shareholders in the firms to which they lend, the agency costs of issuing debt should fall, as

⁴⁴ A dummy variable was used to measure this, for example the variable representing if a firm has a group of dominant owners equals one if one particular group of owner have greater than 50% of shares. Frydman (1997) also used a dummy variable approach.

they will have little incentive to pursue wealth transferring tactics if they are major debt holders of the firm.

This could be relevant for transition economies. Restructuring, requiring investment and debt issuing could be made easier if large debt holders are allowed to acquire large equity holdings, which would reduce any possible agency conflict, as the share holders will be able to monitor the firm, and prevent it from making sub-optimal investments. In addition, allowing financial institutions to monitor corporate policy may also reduce the scope for managerial opportunism, thus also reducing agency conflicts between shareholders and debt holders and shareholders and managers. Prowse (1990) documents that in a situation where major shareholders are financial institutions they will have little incentive to engage in wealth transferring policies, if they are also debtholders, reducing the potential for agency costs. Also there may be a reduction in agency conflict between managers and owners, when financial institutions attempt to control managers consumption of perquisites and curb managerial opportunism. Gerschenkron (1962) also provides evidence that a “bank centred” approach to corporate governance is particularly useful for developing countries. In contrast, La Porta *et al.*, (2000) argue that bank lending ignores the important role of stock markets in the external financing, as equity financing is “*essential for the expansion of new firms whose main asset are the growth opportunities*,”⁴⁶ (p19). Also they document that since the collapse of the Japanese “bank centred” economy this type of system may not be so efficient as Japanese banks have been found to collude with managers on a range of issues.

However, institutional investors may bring advantages to the firm. A study by Kochhar and David (1996) highlights these benefits. They use a sample of 135 firms traded on the New York Stock Exchange to test three competing hypotheses⁴⁷. By examining differences in institutional investors and their ability to influence firms’ activities (namely an outcome based measure of innovation, representing a long term orientation), they provide evidence that

⁴⁵ It has been found by Useem (1993) that institutional investors now control more than 50% of stock in large publicly held corporations.

⁴⁶ However they also argue that the distinction between bank centred and market centred financial systems is not always practical.

⁴⁷ Firstly they test if institutional ownership is negatively associated with the rate of new product development, i.e. institutional investors are *pressure sensitive*. Next they test if institutional ownership is positively associated with the rate of new product development and thus investors are *pressure*

institutional investors are *active* and *pressure resistant*⁴⁸. In this case institutions are “active” when exit from an equity holding is difficult, thus they will be motivated to exercise their “voice” and attempt to influence managerial decisions. Usually these institutions have no business relationships with the firms except an investment connection, in this category come public pension funds, mutual funds and endowments. Thus again institutional investors assume the role of reducing agency conflict. Pound (1988) refers to this as *the “efficient monitoring hypothesis”*.

However, in the same study, Kochhar and David mention several other types of institutional investors, namely the *pressure sensitive institution*, such as *insurance companies, banks, and non bank trusts* (p76). These kind of institution normally assumes a dual role of investor and that of a business relationship, which can hinder the institution’s ability to influence managerial strategy and policy. For example Kochhar and David claim that, “*Institutions that are seeking to maintain an amicable business relationship may be hesitant to influence managerial action.*” Pound (1988) also notes this phenomenon, which he identifies as the conflict of interest problem, occurring when “*fiduciaries are alleged to be frequently swayed in their voting behaviour by existing business relationships with incumbent management,*” p243.

Wahal and McConnell (2000) also attempt to address the proposal that institutional investors may cause managers to under-invest in projects with long term payoffs. They note that in the US during the 1980’s institutional investors were often held responsible for making corporate managers behave myopically. The reason being that institutional investors are impatient (as they are judged upon their short term portfolio performance) and this sentiment is transmitted to corporate managers via pressure on stock prices. As a result managers are forced to concentrate upon projects with a short term pay off.

Thus in the US institutional investors have been accused of focusing solely upon short term earnings, and are eager to drop stock at the first suggestion of a decline.

However Wahal and McConnell also paint a more favourable picture of institutional investors. They state that institutional ownership may act as a “buffer” between impatient individual shareholders and corporate managers, which allows managers to focus on

resistant if they influence managerial actions to pursue investment , or lastly they maybe *superior investors* if they select more innovative firms.

projects with longer term pay offs (p309). Furthermore, they document that institutional owners may have an informational advantage as compared to individual shareholders, consequently they may be less tempted to judge corporate managers on the basis of short term reported earnings.

Their results, using a variety of techniques confirm this and show that institutions do not cause myopia, in fact institutional ownership is associated with greater expenditure for plant, property and equipment and R&D, than is ownership of shares by individual investors.

Furthermore, their results show that active institutional trading is not associated with corporate myopia, in fact it allows managers to adopt a longer investment horizon.

In addition, Johnson *et al.*, (1996) document that the surge in institutional investor stock ownership has evolved into an important monitoring body and *“in many aspects institutional investors have become the monitors of firms’ appointed monitors - the board of directors.”* This body has mainly concentrated upon improving director quality, composition and accountability.

The role of institutional owners in transition economies and the special case of FIGs in the FSU.

Nevertheless, institutional investors in transition economies may evolve to be affected by short-termism or pressure sensitivity, or moreover still be linked with the State or a financial industrial group (see below), which would dampen their incentives to monitor management and attempt to enhance firm performance.

Johnson (1997) researches the potential roles of financial industrial groups⁴⁹ in Russia, such as the industry led FIGs: Skorostnoy Flot, Magnitogorsk steel and the bank led FIGs such as Menatep, Most Group. She attempts to uncover whether FIGs lobby the government for special privileges successfully, collude with each other to restrict competition, or undertake investment and restructuring. Her main findings concerning the industry led⁵⁰ FIGs suggest that they have not been able to restructure enterprises due to a lack of investment capital. Also, they have not been able to succeed in lobbying the State. Conversely, bank led FIGs have to some extent lobbied the State for special privileges successfully (e.g. AlfaBank,

⁴⁸ Jensen also found that institutional investors were active in 1991.

⁴⁹ Russian legislation defines FIGs to be a *“group of enterprises, organisations, lending and financial institutions and investment institutions officially registered at the federal level”*.

p347) as well as having discouraged potential competitors. Yet, several bank led FIGs have undertaken tentative restructuring, for example, Menatep's Rosprom implemented a restructuring plan, which involved downsizing the workforce in 1996. Similarly to industry led FIGs, restructuring has been delayed by a lack of capital⁵¹ as they have not sought capital from foreigners or other domestic institutions due to a fear of relinquishing control. Other criticisms of FIGs have been made by Wright *et al.*, (1998) who claim that the evolution of FIGs represents a continuation of late Soviet era networks, and that in some cases they are created to pressurise enterprises in which they share a relationship, to sell their shares to them.

Perotti and Gelfer (2001) highlight that in the developed world conglomerate firms have been criticised for reallocating resources sub - optimally across divisions, by shifting funds from better performing firms to support investment in less successful sectors. For example, various studies have found evidence that internal power conflicts create inefficient redistribution of resources to badly performing sectors (see Rajan *et al.*, 1998).

However, in developing countries industrial-financial groups have been praised for performing a governance function, creating internal capital markets and monitoring managerial activities (p1602). In the case of Russia, Perotti and Gelfer (2001) state that a shortage of external capital and a weak legal system has advanced the development of FIGs. Using a dataset of 71 Russian public companies in 1995-6, they find that bank led FIGs do partake in extensive financial reallocation, yet they allocate capital comparatively better than other firms.

Financial institutional investors are also examined by Filatotchev and Mickiewicz (2001) in the transition context. They point out that relational financial investors imply both negative and positive effects on company strategy and subsequent performance. The investor's ability to influence the firm depends on their particular characteristics, such as industry membership. In general terms, Filatotchev and Mickiewicz (2001) claim that financial institutions may provide "*bank debt market expertise*" (p17), representing positive effects. This ability to evaluate alternative debt contracts and pricing arrangements may prove to be a very

⁵⁰ These are FIGs which are based in old industries, in the regions, particularly in defence, Johnson, 1996, p334.

⁵¹ Johnson suggests that the cause of this may be a tendency for FIGs to acquire new companies, rather than improve enterprises they already own (p359).

attractive characteristic for constrained firms in transition economies. On the other hand relational investors may not be beneficial for firm strategy and performance: they may collude with other stakeholders to extract private benefits, or may be unable to provide any kind of efficient enterprise monitoring.

In the Russian case, Bim deems outsiders such as voucher investment funds, in Russia, as “*modest and inefficient shareholders*” (p483) as evidence from his survey shows that they are not particularly interested in monitoring management or improving performance.

The financial crisis of 1998 in Russia may cast doubts on the efficacy on the banking sector as an institutional investor. For example, Wright *et al.*, (1998) show that some banks in Russia became insolvent and lost their licenses and their ability to monitor firms. Also Filatotchev and Mickiewicz (2001) state that in a transition context there may be a risk involved in placing the control of enterprises in the hands of relational or institutional shareholders, such as banks, given their direct links with the state.

The studies above have focused on the effect of institutional investors on the level of investment and R&D of the firm, managerial monitoring and firm performance. However in this study, I will examine the impact of institutional investors on exporting activity. In the analytical framework section, it was shown that exporting acts as a strategy undertaken in order to improve performance, thus it is possible that institutional investors endeavour to encourage exporting, in order to gain performance benefits.

From this evidence we have **H12 and H12b**.

H12: institutional share-holding in year Y_{t-1} shall be negatively associated with exporting in year Y , in order to test if institutional investors are “*pressure sensitive*”.

In this case institutional investors will be only focused upon short term gains, and thus will not push for changes in organisational strategy such as exporting, in order to boost firm performance. In some cases these types of investors may be seeking to maintain a business relationship with the firm, and may not be able to influence managerial actions. **We also test the alternative hypothesis**

H12b: institutional share-holding in year Y_{t-1} shall be positively associated with exporting in year Y in order to test if institutional investors are “*pressure resistant*”.

The pressure resistant investor is unlikely to have a business relationship with the firm (apart from an investment link) and is able to influence managerial actions, and push for performance enhancing strategies, such as exporting.

Having reviewed a substantial amount of literature a summary table of principal research findings shall be given.

Table 3: Summary table of literature

Issue	Independent variable	Dependent variable	Relationship
1. Insider/Outsider debate			
Wright <i>et al.</i> , (1996)	insider ownership	corporate risk taking	negative
Filatotchev <i>et al.</i> , (2000)	managerial ownership	exporting strategies	negative
Bhavani and Tendulkhar (2001)	organisational form (limited company)	export propensity	positive
Filatotchev <i>et al.</i> , (2000)	outsider ownership	corporate restructuring	positive
Foreign ownership			
Willmore (1997)	foreign ownership	exporting	positive
Molero (2001)	foreign ownership	exporting	positive
Rojec <i>et al.</i> , (2001)	foreign ownership	exporting	positive
2. Board structure			
Vance (1983)	insider directorships	performance	positive
Daily and Dalton (1994)	board structure	strategic choice and organisational outcomes	varies
Klein (1997)	board structure	performance	no relationship
Wagner <i>et al.</i> , (1998)	homogeneous board structure	performance	positive
3. Managerial turnover			
Managerial turnover and performance			
Filatotchev <i>et al.</i> , (1999)	managerial turnover	performance	positive

Issue	Independent variable	Dependent variable	Relationship
Lausten (2002)	performance	managerial turnover	negative
Managerial turnover and strategic change			
Ocasio (1994)	top management turnover	changes in organisational strategy	positive
4. Ownership concentration			
Demsetz and Lehn (1985)	ownership concentration	performance	no relation
Shleifer and Vishny (1986)	ownership concentration	profit rate	positive
Wruck (1989)	ownership concentration	firm value	positive
Transition economies			
Andreieva and Dean (2001)	ownership concentration	performance	positive
Filatotchev <i>et al.</i> (2001)	ownership concentration	performance	negative
Identity of owners			
Andreieva and Dean (2001)	insider concentration	performance	positive
Filatotchev <i>et al.</i> , (2001)	identity of dominant owners	performance	no relationship
Aukutsionek (1998)	outsider and managerial concentration	performance	positive
5. Institutional ownership			
Kochar and David (1996)	institutional ownership	influence on managerial decisions	positive
Wahall and McConnell (2001)	institutional ownership	expenditure on plant, property, equipment and R&D	positive
Transition economies			
Bim (1995)	institutional ownership	managerial monitoring and firm performance	no relationship

CONTROLS

Apart from the variables to be tested in the hypotheses 1-12 above, three controls were included in the analysis:

C1: the official reported level of industrial decline (measured as the corresponding industry's reported decline in real output over 1993-1996, as a percentage of the 1993 level) shall be positively associated with exporting intensity and propensity, reflecting that a fall in domestic sales acts as a "push factor" for exporting.

The extent of industrial crisis should also be accounted for, claim Pearce and Robbins (1994). In the transition context this can be related to the collapse of the CMEA. Buck *et al.*, (1999) explore how the level of industrial crisis exposes firms to the need for retrenching in terms of labour and capital disposal. They hypothesise that retrenchment actions in terms of gross involuntary dismissals and gross physical disposals of capital assets capital are negatively related to managerial and employee ownership. This is caused by managerial entrenchment, entailing collusion with other employees, which reduces the likelihood of a programme of labour dismissals being passed. Simultaneously it is proposed that the extent of retrenchment activity is influenced by the level and direction of changes in industrial demand, which is found to be an important predictor.

Liuhto and Jumpponen, (2001) examine the internationalisation of largest firms in the Baltic countries, their survey shows that domestic factors, such as small country size push companies abroad. In addition, the second most frequent reason given by firms for internationalisation is "*the necessity to survive*" (p12) as the EU can offer a more stable market.

In an exporting context, Pavord and Bogart (1975) hypothesise that adverse market conditions cause managers to consider exporting, as a means of survival.

Barker and Duhaime (1997) extend the impact of decline, they suggest that firm based decline, where performance is below the industry average, the need for strategic change is high. Yet a firm in decline, which is in a relatively competitive position, compared to other firms in that industry, can be expected to exhibit less particular strategic change, especially if they are amidst a cyclical decline. This is a particularly important issue for firms in transition economies, which have endured a transformational decline.

Thus it can be argued that the extent of industrial decline and the general state of the domestic environment, within the transition context, will affect the decision to export. Industry membership will also alter a firm's decision process (Rao, 1977), several other studies (see Johnason and Williamson Paul, 1975 and Lim *et al.*, 1991) of the export developmental model concentrate upon certain industrial sectors, such as engineering, metals and industrial equipment.

Dominguez and Sequeira (1992) examine the determinants of exporter's performance in central America and find that industry membership is an important determinant of export strategy. Their findings show that the food industry is least reactive (i.e. not concerned with export incentives) while paper and chemical industries were the most reactive. In a latter study by Roberts and Tybout (1997), who analyse the export participation of Colombian firms, also include several industry dummies. Finally, Javalgi (1999) examines the impact of firm characteristics upon exporting across industry type with a dataset of 20,204 firms in the US state of Ohio, they find that industry type does effect whether a firm is an exporter or not.

Obviously some industries are more export orientated, as we have seen above, in Russia the oil industry is heavily involved in foreign trade, thus when studying export propensity it is necessary to consider industry membership. However when industry dummies were included a multicollinearity problem arose, and their removal led to an increase in R^2 and the F statistic. More formally, the F test shows that the removal of the industry dummies is valid (see table 5).

C2a: firm size in year Y_{t-1} will be positively associated with exporting intensity and propensity in year Y.

Firm size has been often included in the existing research as a determinant of exporting activity. For example, Bonnacorsi (1992) highlights the channels in which size may influence the firm: through limited resources, scale economies and risk perception. Empirical conclusions have been very mixed on this matter, Perkett (1963) found a positive correlation between firm size and the percentage of firms that export, others have found no significant relation (Bilkey and Tesar, 1975). Cavusgil (1976) found that very small firms do not export, and after firms reach a certain size, there is no correlation, but in-between these

points exporting is correlated with firm size. More recently, Aw and Batra (1998) report that in Taiwan small and medium enterprises are more likely to diversify geographically, while large firms are more likely to diversify in terms of production. Conversely, Delgado *et al.*, (2001) find that during the period 1991-1996 large firms in Spain have a higher export intensity than small firms. However, Bonaccorsi (1992) raises the important issue of causality, exporting may provide firms with the opportunity to grow, and his analysis of exporting firms in Italy allows him to refute the hypothesis that size is positively related to exporting intensity, as small firms also have access to external resources which may assist the exporting process.

Dharwan (2001) states that the superior advantages of large firms may lie within their ability to gain access to capital, enjoy market power and economies of scale.

Alternatively, we may find large firms may suffer from organisational and managerial lethargy, this is particularly relevant to firms in the former Soviet Union, where some firms have been classified as “dinosaurs”, for example Wright *et al.*, (2001) cite that these enterprises are remnants of the Soviet era.

In prior export research Javalgi *et al.*, (1999) use two measures of firms size in their logit specification: the number of employees and total sales, here in order to avoid multicollinearity, only the number of employees are used.

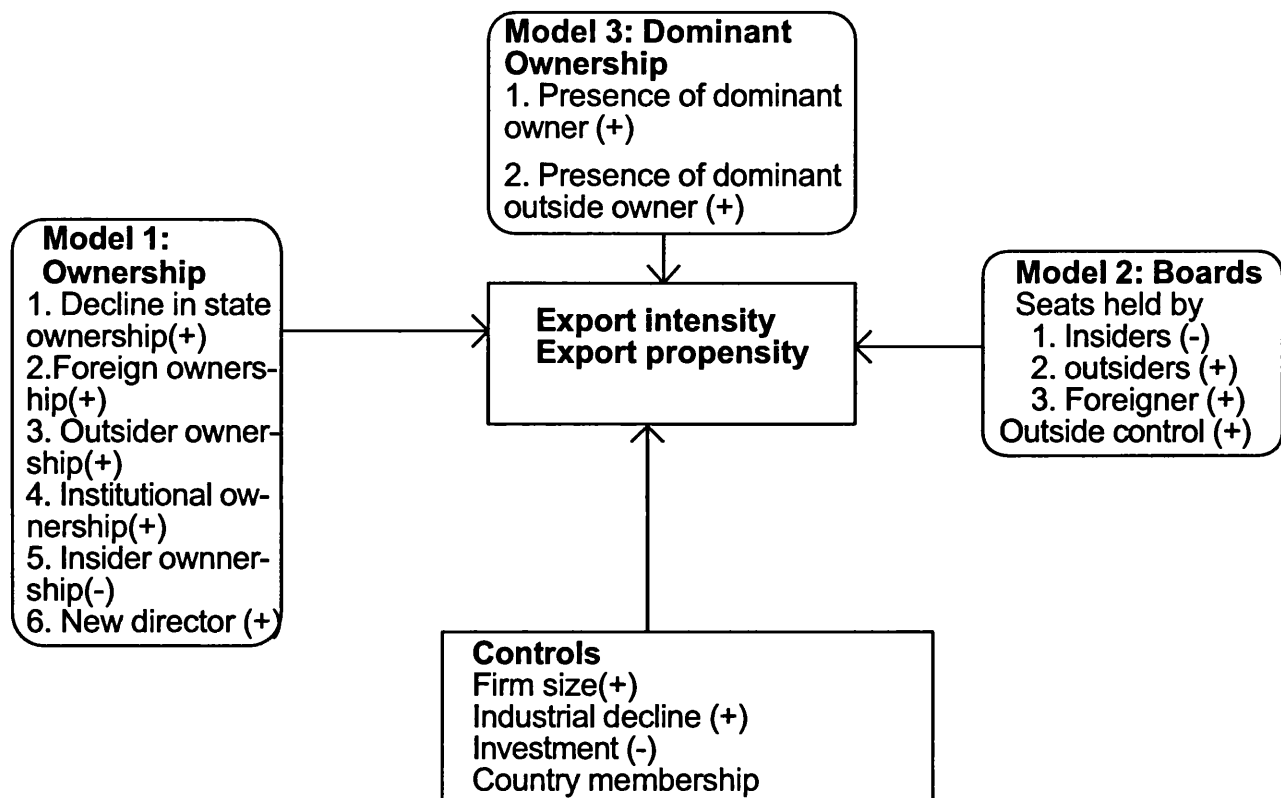
C3: annual investment in year Y shall be negatively linked to exporting intensity and propensity in year Y.

Söderbom and Teal (2001) examine the complex relationship between investment, exporting and skills in manufacturing firms in Ghana using panel data from the 1990's. One of their research questions is to determine whether investment has been higher in exporting orientated sectors. Their results refute this by showing that exports firms are not more likely to be undertaking investment.

Thus in the case of the former Soviet Union we may hypothesise that exporting and investment are negatively correlated, suggesting that they are competing strategies to improve firm performance.

These controls and hypotheses allow us to test the following model:

Diagram two: A model of export behaviour



5.7 Regression analysis

Firstly linear and logit regressions were used to examine the relationship between exporting and ownership and board structure. A dataset adjusted for missing values was also adopted in order to improve the robustness and preciseness of results, as described in the previous methodology chapter.

Several models shall be presented, in this section where the Expectation Maximisation (EM) procedure has been used. Model one examines some of the principal hypotheses concerning ownership structure. Model two then includes board structure and corporate control, while model three tests the hypotheses concerning the impact of a group of dominant owners.

I have chosen Belarus as the numeraire country dummy as this has been the method used by the originators of the dataset (see for example Filatotchev *et al.*(2001b).

Table 4: Linear regression results.

Dependent variable = export intensity in 1997.

Independent variables are measured for 1996.

	Model 2 ⁵² board structure	Variance inflating factor	Model 3 dominant ownership	Variance inflating factor
Constant	-29.36(14.92)		-31.68(16.44)	
Log of number of employees	0.27(2.71)**	1.25	0.26(1.89)†	1.34
Presence of a dominant owner			0.26(1.9)†	1.25
Presence of dominant outside owner			-0.15(-1.19)	1.06
% of seats held by insiders	0.15(0.88)	3.46		
% of seats held by foreigners	-0.11(-0.96)	1.61		
% of seats held by outsiders	0.11(0.44)	8.42		
Industrial decline	0.22(2.07)*	1.42	0.27(1.85)†	1.44
Log of investment	-0.07(-0.79)	1.16	-0.12(-0.91)	1.27
% of voting shares held by outsiders* % of seats held by outsiders	-0.009(-0.04)	5.13		
RUSSIA	-0.13(-1.14)	1.56	-0.19(-1.38)	1.44
UKRAINE	-0.04(-0.35)	1.46	-0.01(-0.07)	1.55
n	223		223	
Adjusted R ²	0.06		0.09	
F statistic	1.78†		1.86†	

⁵² Model 1 is tested using pooled data, see following sections.

^a this is a dummy variable which is equal to 1 if the percentage of shares of the government has fallen during the period 1996-1997, and zero otherwise.

^b standardised beta coefficients are reported and t statistic is in parentheses.

†p<0.1, *p<0.05, **p<0.01, ***p<0.001

Logistic regression was also used following recommendations by Wakelin (1998), and is described in more detail in chapter three. Results from logistic analysis are shown in tables 5 and 7, where the EM procedure is used again to replace missing values.

Table 5: Logistic regression

Dependent variable = is a firm an exporter in 1997.

Independent variables are measured for 1996

	Model 1 ownership structure ^b		Model 2 board structure		Model 3 dominant ownership	
Constant	- 7.81(5.12)		-5.67 (2.14)**		-8.91(2.86)	
Log of no. of employees	0.25(1.84)	^c 1.28	1.33(0.6) *	^c 3.79	2.72(0.94) **	^c 15.17
Decline in state ownership ^a	- 0.26(1.68)	9.58				
% of shares held by foreigners	0.25(0.16) †	01.28				
% of shares held by outsiders	- 0.08(0.06) †	0.9				
% of shares held by institutions	0.19(0.11) †	1.2				
% of shares held by insiders	0.002 (0.002)	1.0				
Presence of a dominant owner					1.45(0.89) *	0.39
Presence of an outside dominant owner					1.07(1.0)	0.23
% of seats held by insiders			-0.02 (0.16)	0.98		
% of seats held by foreigners			-0.16 (0.13)	0.99		
% of seats held by outsiders			0.02 (0.03)	0.98		
% of voting shares held by			-0.0006	1.02		

	Model 1 ownership structure ^b		Model 2 board structure		Model 3 dominant ownership	
outsiders* % of seats held by outsiders			(0.0004)			
Industrial decline	-0.009 (0.04)	0.99	0.01 (0.02)	1.02	-0.006 (0.02)	0.99
Log of investment	- 0.65(0.62)	0.52	0.16 (0.36)	1.16	0.016 (0.36)	1.02
RUSSIA	- 4.97(2.34) *	144.58	-1.59 (0.59)	4.88	-1.29(0.8)*	3.62
UKRAINE	- 3.29(2.34)	27.09	-0.41 (0.99)	1.51	-0.94(1.12)	0.39
n	223		223		223	
% correct	82.05		78.26		73.44	
Hosmer and Lemeshow's R ²	0.6		0.19		0.28	
Chi square	19.24*		23.92**		18.02*	

^a this is a dummy variable which is equal to 1 if the percentage of shares of the government has fallen during the period 1996-1997, and zero otherwise.

^b standard error is in parentheses. ^c This is the indicator of change in odds resulting from a unit change in the independent variable, i.e. the derivative. In SPSS output this is termed as $EXP(\beta)$.

†p<0.1, *p<0.05, **p<0.01, ***p<0.001. Note H9 is not tested due to a failure to meet an iterative solution.

Before results of the analysis are given, attention must be paid to multicollinearity statistics or the variance inflating factors given in tables above.

An assumption of the classical linear regression model is that there is no multicollinearity among regressors in the regression model. Unfortunately Field (2000) states that some degree of collinearity is unavoidable and Gujarati (1995) notes that the fact that explanatory variables are highly collinear is “*a fact of life*” (p319). Yet multicollinearity can still be a problem, despite OLS estimators still being BLUE, precise estimation will be difficult, as estimators have large variances and covariances. Also Field (2000) highlights three particular problems of multicollinearity: it limits the size of R, prevents choosing which variable is important and leads to unstable beta coefficients, (see Field, p132 for more details).

Consequently, variance inflating factors (VIFs) have been calculated, which represent the speed with which variances and covariances increase, and shows how the variance of an estimator is inflated by the presence of multicollinearity.

Montgomery and Peck (1982) highlight that multicollinearity may be caused by several factors, one of them being model specification.

One solution to multicollinearity⁵³ is to acquire more data or increase the number of observations. One method of doing this is to use the EM algorithm procedure, which imputes missing values in the dataset. As the number of observations increase, the variance of the regressors decrease, along with their standard errors, making estimation more precise⁵⁴.

Also it should be noted that various specifications were tried, in addition to those presented here, in particular it was found that by removing industry dummies⁵⁵ the problem of multicollinearity was resolved, without altering the main results.

As for results, general firm characteristics or controls shall be considered firstly. In both the linear and logistic results, by examining the standardised beta coefficients it is evident that firm size (measured by the logarithm of the number of employees) is positively linked to export intensity and propensity. Past research on firm size and exporting has provided mixed findings, yet results presented here tend to agree with that of Bleaney and Wakelin (1999), who find that in the case of UK exporting firms, larger firms export a larger proportion of their total output. They claim that firm size is expected to have a positive relation with exporting as larger firms have more resources to enter foreign markets. These resources are useful for covering the fixed costs of exporting, such as information gathering. Delgado (2001) obtains similar results in his study of Spanish exporting firms: large firms have a higher export intensity than smaller firms.

The logarithm of annual investment is found to be insignificantly associated with export intensity and propensity reflecting that annual investment does not have an impact on whether a firm is an exporter or not or the level of export activity.

⁵³ See Gujarati (1995) for details of solutions (p339-346).

⁵⁴ Also multicollinearity has been reduced from the original specifications by testing several of the hypotheses separately.

⁵⁵ It is hoped that industry characteristics are captured in the “industrial decline” variable.

Caves (1990) suggests that variables representing general business conditions should be included in firm level studies, here the levels of industrial decline are used to represent industry characteristics⁵⁶. Table four shows that the level of industrial decline is positively associated with export intensity, and so a decline in domestic demand acts as an incentive to increase exporting activity.

Hypotheses 6-8 deal with board structure of firms. Specifically 6 tests the relationship between the percentage of board seats held by insiders and export intensity and propensity.

Tables 4 and 5 show that there is no significant relationship between these two variables.

H6 and H7 tests the relationship between the percentage of board seats held by outsiders and foreigners respectively and export intensity and propensity. Tables 4 and 5 reveal that both relationships are insignificant. It is possible that outsider and foreign board members do not have the power to influence exporting strategy, furthermore they may not be fully independent of the CEO and thus forced to adhere to his policies. Baysinger and Hoskisson (1990) also document that outsider directors often hold other directorships and do not have time to carefully monitor firm strategy.

H8 examined the relationship between the interaction variable of outsider share-holding and the percentage of board seats held by outsiders and exporting. The relationship was found to be insignificant, and so H8 was rejected.

Also hypotheses were made surrounding the presence of a group of dominant owners and their identity, H10 postulates that the presence of a group of dominant owners shall have a positive effect on exporting activity. The tables above show that there is support for this hypothesis in model 3. This finding differs from that of Gurkov and Asseleberg (1995), whose results suggest that blockholders do not improve performance in Russia. However, H11 examines the identity of a dominant owner and claims that a group of dominant owners, which consists of outsider ownership, is positively associated with exporting intensity. Results in tables 4 and 5 refute this relationship, thus H11 can be rejected. Yet is interesting to note that these results differ from those of Andreyana and Dean (2001) who find that in Ukraine a concentration of insider ownership improves firm performance, but agree with Filatotchev *et al.*, (2001), who find that the identity of a dominant owner does not affect performance.

Lastly a brief note on the $EXP(\beta)$ or derivatives shall be given, which are shown in the logistic regression results tables shall be mentioned. As for the ownership regression in model 1 we can see that a decline in state ownership has the largest $EXP(\beta)$ at 9.57, as this value is greater than 1 this indicates that as state ownership declines the odds of a firm being an exporter increases. In this case we can say that the odds of a firm which has experienced a decline in state ownership and also being an exporter is almost 10 times more likely than those of a firm without a decline in state ownership. Other interesting findings are those $EXP(\beta)$ for firm size (1.27) and foreign ownership (1.28), both of which indicate a positive effect on whether a firm is an exporter or not.

Firm size also has a large and positive $EXP(\beta)$ in models 2 and 3 at 3.79 and 15.17.

Model 3 also exhibits an $EXP(\beta)$ of 2.91 for the presence of a dominant owner, thus the odds of a firm which has a dominant owner and is an exporter is almost three times higher in firms than those without a dominant owner.

From the linear regressions in table 4 we can see that all models have modest R^2 .

As for logistic regressions, models 1 may be the most useful as it successfully classifies almost 80% of the cases. Model 3 has a reasonable value of Hosmer and Lemeshow's R^2 , which is an indicator of how well independent variables predict the outcome variable.

It should be noted that to test model one pooled data regression was used, as the test for time invariance was accepted for this model only (see section 5.9). In addition the pooled dataset was used for logistic regression, yet this produced insignificant results and a poor classification rate, therefore the results are not presented here.

The analysis described above was then carried out using export intensity and propensity in 1996 as the dependent variable, and independent variables were taken from 1994. The reason for the two year lag is that the survey provided responses for 1997, 1996, and 1994, thus it was decided to take advantage of this time lag⁵⁷.

⁵⁶ As mentioned previously industry dummies were removed to reduce multicollinearity.

Table 6: Linear regression results.

Dependent variable = export intensity in 1996

Independent variables are measured for 1994

	Model 2 board structure	Variance inflating factor	Model 3 dominant ownership	Variance inflating factor
Constant	-34.16(11.37)		-35.39(10.55)	
Log of number of employees	0.25(3.20)**	1.34	5.42(1.54)*	1.33
Presence of a dominant owner			0.03(0.35) †	1.09
Presence of dominant outside owner			0.06(0.83)	1.05
% of seats held by insiders	0.08(0.82)	1.9		
% of seats held by outsiders	-0.36(- 2.83)**	3.65		
Industrial decline	0.21(2.88)**	1.21	0.21(2.7)**	2.96
Log of investment	0.09(0.75)	3.16	0.004(0.03)	2.97
% of voting shares held by outsiders* % of seats held by outsiders	0.25(2.22)*	2.86		
RUSSIA	-0.09(-1.02)	1.68	-0.12(-1.3)	1.59
UKRAINE	-0.14(-1.06)	3.61	-0.19(-1.41)	3.53
n	223		223	
Adjusted R ²	0.17		0.12	
F statistic	5.81***		4.48***	

⁵⁷ Another possible technique would be to pool the data; see the following section.

Tests for the inclusion of industry dummies : $H_0 = \text{metal dummy} = \text{engineering dummy} = \text{food dummy} = \text{paper dummy} = 0$ ⁵⁸

	Model 2 Board structure	Model 3 Dominant owners
F statistic	2.09	1.7
F critical value ($F_{0.01}(4,206)$)	3.41	3.41
Result	Accept	Accept

^a this is a dummy variable which is equal to 1 if the percentage of shares of the government has fallen during the period 1996-1997, and zero otherwise.

^b standardised beta coefficients are reported and t statistic is in parentheses.

^c $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Note. I was unable to test the effect of board seats held by foreigners on exporting, as this variable had to be dropped in order to find an iterative solution

Table 7: Logistic regression results.

Dependent variable = export propensity in 1996

Independent variables are measured for 1994

	Model 1 ownership structure		Model 2 board structure		Model 3 dominant ownership	
Constant	-16.49 (5.09)**		-7.69 (1.91)		- 7.81(1.79) ***	
Log of no. of employees	2.06 (0.67)*	^c 7.82	0.85 (0.23)** *	^c 2.35	0.9(0.23)*	^c 2.46
Decline in state ownership ^a	0.29 (1.39)	0.75				
% of shares held by foreigners	-0.27 (0.33)	0.76				
% of shares held by outsiders	0.0008 (0.03)	1.0				
% of shares held by institutions	0.009 (0.04)	1.0				
% of shares held by insiders	-0.006 (0.02)	0.99				
Presence of a dominant owner					-0.93(0.59)	0.39

⁵⁸ See Gujarati (1995), pg58 for a description of the F test.

	Model 1 ownership structure		Model 2 board structure		Model 3 dominant ownership	
Presence of an outside dominant owner					-6.6(23.52)	0.86
% of seats held by insiders			0.003 (0.01)	1.0		
% of seats held by outsiders			-0.03 (0.02)†	0.97		
% of voting shares held by outsiders*% of seats held by outsiders			0.0004 (0.0005)	0.97		
Presence of a new director	0.41 (0.87)	0.66				
Industrial decline	0.03 (0.04)	1.03	0.01 (0.01)	1.01	0.01(0.01)	1.01
Log of investment	-0.02 (0.17)	0.98	0.14 (2.82)†	1.16	0.12(0.08) †	1.12
RUSSIA	0.54 (1.39)	1.71	-0.65 (0.44)	0.52	-0.22 (0.460)	0.79
UKRAINE	1.21 (1.28)	3.34	0.73 (0.74)	2.07	0.82(0.72)	2.28
n	223		223		223	
% correct	80.0		74.14		72.87	
Hosmer and Lemeshow's R ²	0.63		0.78		0.79	
Chi square	31.51***		50.43***		42.49***	

* this is a dummy variable which is equal to 1 if the percentage of shares of the government has fallen during the period 1996-1997, and zero otherwise.

^b standard error is in parentheses. ^c This is the indicator of change in odds resulting from a unit change in the independent variable, i.e. the derivative. In SPSS output this is termed as $EXP(\beta)$.

†p<0.1, *p<0.05, **p<0.01, ***p<0.001

Note the variable for the percentage of seats held by foreigners was removed due to a failure to meet an iterative solution.

Results in tables 6 and 7 show that the relationship between exporting intensity and propensity and ownership structure changes when a two year lag is used, and is thus unstable over the period 1994-7. Bilkey (1976) in his detailed review of export studies notes that unstable equation coefficients are common, when the firm moves from one stage of the export process to the next (p42).

Beginning with firm characteristics we can see that firm size is again, positively and significantly related to export intensity and propensity.

However the relationship between lagged investment and export propensity is positive and significant for this period in models 2 and 3. This refutes C3 perhaps suggesting that investment and exporting are complementary strategies to improve performance.

The relationship between industrial decline and export intensity is positive in models 2 and 3 (similar to results in table 4), thus a fall in domestic sales act as a “push factor” to increase export intensity. However, it does not act as an incentive to begin exporting per se. Similar to the analysis using 1997 as a dependent variable, industry dummies are not included in the regression equation, the table above provides a formal F test, proving that their exclusion is valid.

As for ownership variables only those that have significant relationships shall be discussed. Linear and logistic regression results reveal that the percentage of board seats held by outsiders reduce the likelihood that a firm is an exporter and export intensity, providing evidence to reject H6⁵⁹. The reason for this could be that outside board members monitor managers from over diversifying⁶⁰, and thus leads to a negative relation between board seats held by outsiders and exporting activity. For example, Chen and Ho (2000) found that for firms in Singapore outside blockholders prevent over-diversification.

Alternatively, Wagner *et al.*, (1998) state that the resource dependence perspective proposes that outside directors ease the acquisition of resources required by firms to survive and function, however in the FSU outside directors may not have the experience or means to acquire these important resources.

Model 2 from the linear regression also shows that H8 can be accepted: outsider control is positively associated with export intensity. This may reflect complementarities between the voting shares and presence on boards: outsiders need both to impact on exporting.

Turning to the presence of a group of dominant owners, model 3 shows that this is positively associated with export propensity, thus we may accept H10. Again the identity of the group of dominant owner does not affect the relationship.

⁵⁹ This result differs from the findings in the previous regression, which revealed an insignificant relationship.

⁶⁰ Whereby the agency cost hypothesis states that managers derive private benefits from diversification which exceed their private costs, (Chen and Ho, 2000).

Once again a brief observation of the $EXP(\beta)$ shall be given which are shown in table 7. Similarly to table 5 firm size has a relatively large and positive $EXP(\beta)$; 7.81 in model 1, 2.34 in model 2 and 2.46 in Model 3, again suggesting that the odds of a firm being an exporter is higher in larger firms. As for industrial decline in model 1 this is positive at 1.03 reflecting that the odds of a firm that is suffering from industrial decline and is an exporter is 1.03 times more likely to be an exporter than a firm which is not suffering from decline. Lastly coming to model 3 the $EXP(\beta)$ for dominant owner is 0.86, as this is less than 1 this suggests that the odds of the firm being an exporter decreases when the firm has a dominant owner.

By examining the F statistics in table 6 for the linear regression we can see that they are significant, thus we can reject the hypothesis that the regression coefficients are equal to zero and say the relationship between the dependent and independent variables is valid. In order to evaluate the success of the logistic regression in table 7, Hosmer and Lemeshow's R^2 can be used: the highest value is 0.79, reflecting that the independent variables are fairly good predictors of the outcome variable, in addition all four models correctly classify greater than 74% of all cases (this is favourable compared to similar analysis by Javalgi *et al.*, (1999) who achieved a correct classification of 72%).

5.8 Accounting for Heteroscedasticity

The scatter-plots in the chapter three show that the fourth assumption of the classical linear regression model of homoscedastic disturbances has been broken, thus the weighted least squares procedure has been used.

In addition, a more formal test was carried out in order to detect heteroscedasticity. By employing the Goldfield Quandt test (see Gujarati, p374 for a detailed treatment of the method) it was found that we cannot accept the hypothesis of homoscedasticity for three out of four models, as shown in the table below.

The Goldfield Quandt⁶¹ test takes the following form:

$$\lambda = \frac{RSS1 / df}{RSS2 / df}$$

⁶¹ RSS refers to residual to residual sum of squares, df refers to degrees of freedom

If we find that λ is greater than the F critical value then we may reject the hypothesis of homoscedasticity, λ and the critical F value are shown in the last rows of table 8.

Results are shown using the WLS procedure (refer to chapter three for a description of this technique) for dependent variables measured in 1997 and 1996. We have two models for each year; model one examines the impact of ownership structure on export intensity and model 2 examines the impact of board structure on export intensity⁶².

Table 8a: Regression results using WLS.

	Dependent Variable measured in 1997 Ownership structure	Dependent Variable measured in 1997 Board structure	Dependent Variable measured in 1996 Ownership structure	Dependent Variable measured in 1996 Board structure
Constant	15.21(9.04)	-29.26(14.97)*	-39.77(12.54)**	-28.44(8.67)**
Log of employees ⁶³	-2.24(3.09)	10.24(3.77)**	6.72(1.69)***	4.56(1.33)***
Decline in state ownership	1.58(2.51)		4.07(4.56)	
% of shares held by institutions	0.42(0.13)**		-0.14(0.16)	
% of shares held by foreigners	3.7(0.22)***		1.25(1.17)	
% of shares held by outsiders	-0.2(0.07)*		-0.03(0.11)	
% of shares held by insiders*			0.01(0.07)	
Presence of a new director	-2.89(2.46)		-1.49(3.55)	
Industrial decline	0.24(0.09)*	0.23(0.11)*	-0.05(0.13)	0.22(0.09)*
Log of investment	-3.59(1.02)**	-1.97(2.53)	0.42(0.54)	0.38(0.48)
% of seats held by insiders		0.09(0.11)		
% of seats held by foreigners		-0.88(0.9)		n.a
% of seats held by outsiders		0.07(0.19)		-0.36(0.09)***
% of shares held by outsiders *% of seats held outsiders		0.0001(0.002)		0.004(0.002)*
Russia	-2.37(3.44)	-4.6(4.18)	2.26(5.18)	-1.79(2.89)
Ukraine	-9.96(3.42)**	-2.79(7.55)	7.33(4.78)	-2.89(4.47)
Adjusted R square	0.96	0.06	0.26	0.19
F statistic	66.08***	1.77†	3.12**	7.04***
Goldfield Quandt test for OLS				

⁶² Model three which previously examined the impact of dominant owners is not presented as it produced insignificant results.

⁶³ Independent variables are lagged, as before in linear/logistic regression

	Dependent Variable measured in 1997 Ownership structure	Dependent Variable measured in 1997 Board structure	Dependent Variable measured in 1996 Ownership structure	Dependent Variable measured in 1996 Board structure
technique				
λ value	11.69	1.44	1.04	1.44
F critical value	$F_{0.01}(6,31)=3.47$	$F_{0.1}(36,45)=1.29$	$F_{0.25}(60,9)=1.54$	$F_{0.1}(36,45)=1.29$
Result	Reject homoscedasticity: apply WLS	Reject homoscedasticity: apply WLS	Accept homoscedasticity	Reject homoscedasticity: apply WLS

*Source variable for weight. ***p<0.001, **p<0.01, *p<0.05, †p<0.1

Table 8b: WLS results using pooled data

	Ownership structure	Board structure
Constant	-24.52(8.87)	-37.12(10.03)
Log of employees	0.81(1.3)***	0.58(1.29)***
Decline in state ownership	-0.11(-1.27)	
% of shares held by institutions	0.09(0.1)	
% of shares held by foreigners	0.61(0.34)***	
% of shares held by outsiders	-0.09(0.07)	
% of shares held by insiders*		
Presence of a new director	-0.05(2.2)	
Industrial decline	0.07(0.07)	0.21(1.29)***
Log of investment	0.39(-0.08)	0.05(0.47)
% of seats held by insiders		0.09(0.05)
% of seats held by outsiders		-0.21(0.08)**
% of shares held by outsiders *% of seats held outsiders		0.15(0.001)*
Russia	0.04(2.63)	-0.12(2.48)†
Ukraine	-0.04(2.93)	-0.13(4.1)
Time	0.55(5.31)*	0.49(5.16)***
Adjusted R square	0.47	0.14
F statistic	8.93***	6.59***

*Source variable for weight. ***p<0.001, **p<0.01, *p<0.05, †p<0.

By employing the WLS method allows us to make the following observations.

By referring to table 8, when the dependent variable is measured for 1997, we can see that outsider ownership is negatively and significantly associated with export intensity, thus H2⁶⁴ must be refuted.

⁶⁴ H1 cannot be tested, as insider ownership is used to compute the weighted variable.

This raises the issue of endogeneity as insiders may be preventing outsiders from acquiring shares in better performing firms (i.e. those firms which are exporting), thus accounting for the lack of a positive relationship between exporting and outsider ownership.

H3 concerns the relationship between foreign ownership and exporting, the results provide support for H3 reflecting that foreign ownership furthers exporting, and that we can deduce that foreign owners are using foreign sourcing as a means of production, as suggested by Caves (1996).

However this relationship only holds when the dependent variable is measured in 1997, not 1996, this may suggest that it takes foreign owners time to build up power and ability to influence corporate strategy.

The relationship between board structure and export intensity is examined in H5 and H6. H5 examines the relationship between the percentage of seats held by insiders and exporting, from the results we can see that the association is insignificant, so the hypothesis cannot be accepted. As for the percentage of board seats held by outsiders, the relationship is negative and significant, (when the dependent variable is measured in 1996) reflecting that outsider board members may be focused upon domestic strategy, consequently, H6 is rejected, as in linear and logistic regressions above.

Hermacht and Weisbach (2001) state that boards are not often involved in the day to day business of the firm, therefore we may be able to hypothesise that board members focus on financial performance, as opposed to general exporting policy.

By using the WLS technique, results reveal that the relation between the interaction of outsider shareholders and their board seats is positive and significant, allowing us to accept H8. This reflects that ownership in terms of voting shares may not be enough to allow shareholders to affect strategy, rather they require a presence on the board to be able to initiate performance improving activities, such as exporting. Thus board members in the FSU are involved in export policy, not just financial performance, as found previously by Hermacht and Weisbach (2001).

Lastly, institutional ownership appears to be “pressure resistant”, as institutional shareholding is positively associated with exporting H12b can be accepted, and H12 can be rejected. This result agrees with past research by Kochar and David (1996) in that institutional investors are found to be “active” in improving firm performance. Results here

show that institutional investors are “active” and act as “efficient monitors” (Pound, 1988) in improving export activity, as we assume that exporting is a strategy to improve firm performance these results become comparable

As for controls, several models in linear and logistic regression above revealed that industrial decline is positively associated with exporting, results from WLS mirror this (see model 2).

The country dummy for Ukraine was negative and significant in models 1, reflecting that export intensity is lower in Ukraine, as compared to the control, Belarus.

In addition, the logistic regression revealed that investment is positively associated with exporting, however in models 1 for 1997, we find that the relationship takes the opposite sign. This result agrees with that of Soderbom and Teal (2001) who find that investment is not higher in exporting African firms, thus exporting and investment maybe competing strategies to improve performance.

Lastly we have strong evidence that firm size is positively associated with export intensity, this further consolidates results presented in the regression section above in 5.7.

Table 8b shows results of pooled regressions using WLS techniques.

Once again we have evidence to support H3⁶⁵ and H8, but H5 must be rejected, these findings are consistent with previous results above.

5.9 Pooled regression analysis

In order to take advantage of the fact that we have several time points for the dependent variable the data was pooled, and the appropriate techniques applied. I did this by “stacking” the appropriate variables by year, so for example the dependent variable, export intensity observations are stacked for 1994–6 and 1997. However it is noticeable that the sample size does not increase by any great magnitude, the reason being that the dataset is not longitudinal for Belarus and Ukraine, so some observations had to be deleted.

Furthermore, some Russian firms did not appear in both waves of the surveys due to bankruptcy or non response. However it is anticipated that pooling does bring some benefits (see chapter 3 for details).

⁶⁵ In order to determine whether the data was “poolable” separate equations were run including interactive slope coefficients. For the ownership model (1) institutional ownership and employee ownership interacted with time dummies were significant, suggesting that the single year equations may

As to the question whether the countries are similar enough to pool Filatotchev *et al.* (1999) note that Russia, Ukraine and Belarus share a “*common heritage*” in that they inherited some partial privatisations under the USSR’s legislation of 1989, which allowed enterprise collectives to lease their plant and machinery from the state. Later in 1992 legislation allowed these three countries to buy out their enterprises within the period of their lease (p1015). Although Russia and Ukraine and Belarus went on to adopt different centralised privatisation programmes enterprise managers all faced similar problems with restructuring and adapting their products to be exported beyond the CIS.

Firstly it is assumed that all coefficients are constant across time and firms, however I have included a dummy variable to represent which year the dependent variable was measured in. The coefficients are estimated via OLS technique (see chapter three for more details of pooled regression techniques).

Table 9: Pooled regressions

	Model 1 ownership structure ^b	Variance inflating factor
Constant	-35.41(3.97)***	
Time dummy	0.91(3.66)***	9.15
Log of number of employees	1.07(4.67)***	7.74
Decline in state ownership ^a	-0.13(-1.39)	1.66
% of shares held by foreigners	0.37(4.13)***	1.21
% of shares held by outsiders	-0.06(-0.54)	9.15
% of shares held by institutions	-0.04(-0.36)	1.66
% of shares held by insiders	-0.13(-1.08)	2.27
Presence of new director	-0.03(-0.29)	1.21
Industrial decline	0.03(0.35)	1.36
Log of investment	-0.02(-0.18)	2.45
RUSSIA	0.03(0.31)	1.74
UKRAINE	0.07(0.52)	2.81
n	229	
Adjusted R ²	0.32	
F statistic	4.97***	

^a this is a dummy variable which is equal to 1 if the percentage of shares of the government has fallen during the period 1996-1997, and zero otherwise.

^b standardised beta coefficients are reported and t statistic is in parentheses.

†p<0.1, *p<0.05, **p<0.01, ***p<0.001

Focusing on significant independent variables only, we can see that several of the results in table nine reinforce results found in previous linear, logistic and WLS regressions shown in the sections above.

For example, we have evidence to support H3 once again: foreign ownership is positively associated with export intensity. In addition, firm size is positively associated with export intensity as before.

5.9b Allowing for time variance

Considering that I assumed that coefficients are constant across time it is interesting to see that the time dummy variable is highly significant in table nine. In order to test the validity of the inclusion of this time dummy an F test was carried out, taking the following form:

$$F = \frac{(R_{ur}^2 - R_r^2)/m}{(1 - R_{ur}^2)/(n-k)}$$

(See Greene (2000), p300 and Gujarati (1995), p258).

Where UR represents the unrestricted regression, R represents the restricted regression, m represents the number of restrictions (1 here only) and k represents the number of parameters to be estimated.

The null hypothesis to be tested was $H_0: \beta_0 \text{ Time} = 0$, and results are shown in the table below:

Table 10: F

	Model 1
F statistic	27.67
F critical value $F_{0.01}(1,216) = 6.76^{66}$	6.76
Result	Reject null

Gujarati (2001) warns that not all data is “poolable” and panel data regression models may not be appropriate in every situation (p646). In addition, we assumed that coefficients do not vary across time, but table ten shows that this assumption may not be tenable, as the time dummy is highly significant, and we cannot accept the null hypothesis that the coefficient on the time dummy is zero. Therefore we will test a regression model which includes *interactive slope dummies* to account for differences in slope coefficients, by multiplying the main independent variables by the time dummy, as shown below. Once again we are using this “stacked” dataset as explained above:

$$Y_{it} = \alpha + \beta_1 \text{TIME} + \beta_2 X_{2t} + \text{TIME}\beta_2 X_{2t} + \dots + \beta_n X_{nt} + \text{TIME}\beta_n X_{nt} + u_{it}$$

If one or more of the coefficients on the interactive variables are statistically significant, it will reflect that the slope coefficient is different from the base group (where the dependent

⁶⁶ For model three we use the following F critical value $F_{0.05}(1,216) = 389$.

variable is measured in 1997), and thus there may be little point in estimating a pooled regression model (Gujarati, p645, 2001).

Results shown in the table below demonstrate that for model 1 it may be advantageous to pool the data, but as for models 2 and 3, several interactive variables are significant (such as the interaction of the time dummy with percentage of seats held by outsiders and the presence of a dominant owner), therefore it may be advisable to consider the single equation models, in section 5.7, as the export equations are changing over the time period.

Table 11: pooled regressions with interactive variables

	Model 1 ownership structure ^b	Variance inflating factor	Model 2 Board structure	Variance inflating factor	Model 3 dominant ownership	Variance inflating factor
Constant	-39.73(-3.57)**		-33.87(-3.0)**		-33.27(-3.51)**	
Time dummy	1.21(1.68)	73.92	0.22(0.49)	71.95	0.08(0.18)	50.25
Log of number of employees	1.18(4.58)***	9.43	0.51(3.23)**	8.83	0.51(3.37)**	5.8
Log of number of employees* TD (time dummy)	-0.17(-0.24)	66.38	0.27(0.99)	26.24	0.23(0.61)	36.58
Decline in state ownership ^a	-0.13(-1.3)	1.4				
% of shares held by foreigners	0.24(1.2)	5.35				
% of shares held by foreigners*TD	0.18(0.94)	5.31				
% of shares held by outsiders	-0.14(-0.11)	2.52				
% of shares held by outsiders*TD	-0.14(-0.62)	7.02				
% of shares held by institutions	-0.14(-1.04)	2.67				
% of shares held by institutions*TD	0.2(1.33)	3.27				
% of shares held by insiders	1.01(0.35)	1186.07				

	Model 1 ownership structure^b	Variance inflating factor	Model 2 Board structure	Variance inflating factor	Model 3 dominant ownership	Variance inflating factor
% of shares held by insiders*TD	-1.16(-0.39)	1271.459				
Presence of a dominant owner					0.15(1.43)	2.25
Presence of a dominant owner*TD					0.19(1.54)†	4.03
Presence of dominant outside owner					0.08(0.95)	1.68
Presence of dominant outside owner*TD					-0.12(-1.39)†	1.87
% of seats held by insiders			0.08(0.87)	3.21		
% of seats held by insiders*TD			-0.02(-0.09)	18.06		
% of seats held by outsiders			-0.37(-2.79)**	6.34		
% of seats held by outsiders*TD			0.19(1.41)*	6.31		
Presence of new director	-0.03(-0.36)	1.31				
Industrial decline	0.004(0.03)	2.64	0.23(2.86)**	2.21	0.22(2.76)*	1.68
Industrial decline*TD	-0.01(-0.06)	9.22	-0.05(-0.34)	8.74	0.02(0.09)	6.76
Log of investment	-0.03(-0.18)	2.72	0.08(0.94)	2.82	0.04(0.37)	2.56
% of voting shares held by outsiders*% of seats held by outsiders			0.4(2.19)*	11.75		
% of voting shares held by outsiders*% of seats held by outsiders*TD			-0.29(-1.54)*	12.43		
RUSSIA	0.06(0.51)	2.08	-0.11(-1.52)	1.72	-0.14(-1.86)	1.54
UKRAINE	0.07(0.47)	2.94	-0.11(-1.17)	3.09	-0.14(0.19)	3.01
n	229		229		229	

	Model 1 ownership structure^b	Variance inflating factor	Model 2 Board structure	Variance inflating factor	Model 3 dominant ownership	Variance inflating factor
Adjusted R ²	0.29		0.14		0.12	
F statistic	3.34***		4.49***		3.88***	

^a this is a dummy variable which is equal to 1 if the percentage of shares of the government has fallen during the period 1996-1997, and zero otherwise.

^b standardised beta coefficients are reported and t statistic is in parentheses.

†p<0.1, *p<0.05, **p<0.01, ***p<0.001

The F test proved that for model 1 it may be valid to pool the data as shown below in table 12.

The null hypothesis to be tested for model 1 was H_0 : Log of employees*TD= % of shares held by institutions*TD= % of shares held by employees*TD = % of shares owned by foreigners*TD = % of shares owned by outsiders*TD = industrial decline*time dummy = 0.

Table 12: F

	Model 1
F critical value	$F_{0.01}(6,210) = 2.89$
F statistic	1.29
Result	Cannot reject null

As for models two and three, several of the interactive slope dummies are significant thus we can conclude that there is little use in pooling the data for these equations, and thus it maybe advantageous to run regressions for each year separately, therefore results in section 5.7 are more reliable.

5.10 Summary and conclusion

The table below compares selected main results from regression analysis using OLS and WLS.

Table 13: Summary of results

I= insignificant relationship.

A= accept hypothesis

R= reject hypothesis

NA = not applicable in this specification

	OLS, Pooled Model 1	Dependent variable measured in 1997 (WLS) Ownership structure	Dependent variable measured in 1996 (WLS) Board structure
H1 <i>insider ownership</i>	I	NA	NA
H2 <i>outsider ownership</i>	I	R	NA
H3 <i>foreign ownership</i>	A	A	NA
H4 <i>decline in state ownership</i>	I	I	NA
H5 <i>% of board seats held by insiders</i>	NA	NA	NA
H6 <i>% of board seats held by outsiders</i>	NA	NA	R
H7 <i>% of board seats held by foreigners</i>	NA	NA	NA
H8 <i>outsider control</i>	NA	NA	A
H9 <i>change in top management</i>	I	I	NA
H10	NA	NA	NA

	OLS, Pooled Model 1	Dependent variable measured in 1997 (WLS) Ownership structure	Dependent variable measured in 1996 (WLS) Board structure
<i>presence of a group of dominant owners</i>			
H11 <i>presence of a group of dominant outside owners</i>	NA	NA	NA
H12a <i>pressure sensitive institutions</i>	I	R	Na
H12b <i>pressure resistant institutions</i>	I	A	NA

In addition table 13 summarises results of the logistic regression analysis

Table 13b: Summary of results

I= insignificant relationship.

A= accept hypothesis

R= reject hypothesis NA= not applicable to this specification

	Logistic regression: Dependent variable measured in 1997	Logistic regression: Dependent variable measured in 1996
H1 <i>insider ownership</i>	I	I
H2 <i>outsider ownership</i>	R	I
H3 <i>foreign ownership</i>	A	I
H4 <i>decline in state ownership</i>	I	I
H5 <i>% of board seats held by insiders</i>	I	I

	Logistic regression: Dependent variable measured in 1997	Logistic regression: Dependent variable measured in 1996
H6 <i>% of board seats held by outsiders</i>	I	R
H7 <i>% of board seats held by foreigners</i>	I	NA
H8 <i>outsider control</i>	I	I
H9 <i>change in top management</i>	NA	I
H10 <i>presence of a group of dominant owners</i>	A	I
H11 <i>presence of a group of dominant outside owners</i>	I	I
H12a <i>pressure sensitive institutions</i>	R	I
H12b <i>pressure resistant institutions</i>	A	I

This section shall aim to give a summary of the principal findings and make some tentative conclusions from the analysis.

Several firm characteristics were included in the regression analysis, such as firm size, measured by the number of employees. This is positively associated with export intensity and propensity. From this analysis it is clear that the advantages of economies of scale and scope associated with firm size assists exporting activity.

The lagged annual investment level has been insignificant for most models. When it is significant we have mixed evidence, as shown in tables seven and eight.

Country dummies for Ukraine and Russia, appear to be negatively associated with exporting, compared with the control, Belarus, for some of the models, possibly reflecting that Belarussian firms have a greater incentive to send surplus products to export markets, due to a relatively smaller domestic market.

As for ownership characteristics, despite concerns that insiders may have reason to block exporting, due to the risk and sunk costs involved, tables show mixed, insignificant results, thus it can only be tentatively concluded that insider owners do not hinder exporting activity. Surprisingly outside ownership has not been found to be positively linked to exporting activity, this may reflect that outside owners concentrate on domestic strategy, or do not have the power or incentive to initiate exporting policy, which can be explained by their lack of representation on the board.

Data analysis showed that foreign ownership positively influences exporting, reflecting that foreign owners are concentrating upon servicing foreign market, and are *foreign sourcing* (Caves, 1996).

Several models using logistic regression and WLS has shown that institutional owners are “pressure resistant”, and therefore, are positively associated with exporting. This contrasts with the conflict of interest hypothesis advocated by Pound (1988) yet agrees with Kochar and David (1996), who found that institutional owners positively effect firm performance. Results consistently showed that a decline in state ownership is not significantly associated with exporting activity, reflecting that the state does not have much involvement with export strategy.

The effect of board structure upon exporting also featured in the analysis. It was found that the board representation of insiders was not significantly associated with exporting.

In addition, board representation of foreigners was found not to be positively linked to exporting, suggesting that their weak position on boards does not allow them to further exporting policy or that they are forced into colluding with other board members on exporting issues. However, board representation of outsiders is negatively associated with export intensity and propensity, thus suggesting that outsider board members focus on monitoring domestic strategy and directing sales to the domestic market. Furthermore, the interaction of outside ownership and board representation appeared to be a positive factor

in determining export intensity, reflecting that it is necessary for outsiders to have influence in terms of voting shares and presence on the board.

Lastly, the effect of a dominant owner on exporting was explored. It appears that groups of dominant owners are responding to the poor legal environment and exercising their voice function. Results show that the presence of a group of dominant owners is positively associated with exporting activity, suggesting that when similar groups of owners are in a dominant position they are able to monitor managers more easily, and ensure that corporate resources are used correctly. This confirms Pound's (1988) efficient monitoring hypothesis. Furthermore, results show that groups of dominant owners may behave in a similar fashion to a single dominant owner. For example, Wruck (1989) finds that single blockholders also undergo the cost of monitoring in order to enhance firm performance. In addition these results confirm the hypothesis of Dyck (2000), in that multiple blockholders may be efficient in an environment where legal protection is poor.

Nevertheless, the presence of a group of dominant *outside* owners is not associated with exporting activity, suggesting that the identity of a group of dominant owners does not affect its ability to monitor and implement corporate policy.

As means of conclusion, analysis has shown that larger firms, foreign ownership, a group of dominant owners, and some degree of institutional ownership, along with outsider representation on boards *and* ownership are associated with exporting activity.

The following chapter assumes that foreign ownership or more exactly the existence of a foreign partner brings certain benefits to the firm. As we have seen from the literature review in section 5.3 above foreign ownership is expected to bring several positive attributes to the firm, and results have shown that foreign ownership furthers exporting activity. Thus we attempt to determine which firms attract a foreign partner. More importantly we aim to explain the presence or non presence of foreign partners in the three countries in question.

CHAPTER SIX: FOREIGN PARTNER SELECTION IN THE FORMER SOVIET UNION¹

5.1 RATIONALE FOR STUDY

Benefits of Foreign ownership

The literature documents the many benefits² of foreign ownership³ for the host economy, in terms of export performance, economic growth, spillovers⁴ and industrial transformation, some of which are documented below.

The role of foreign direct investment (FDI) has been expected to be great, *“FDI is often seen as an important catalyst for the economic transformation of the ECE economies,”* as documented by the UN ECE, 2001.

More recently, Radosevic (1999) notes that FDI has a direct impact on the local economy by increasing capacity and improving productivity, and an indirect impact through the training of local suppliers and diffusion of technology and knowledge. However he notes that the dynamic effects of FDI, such as increases in human capital stock, productivity and positive spillovers are more important. Nevertheless, there are qualifications to these advantages, for example the host country must have reached a certain threshold of development and have the absorptive capacity⁵ to benefit from FDI. Furthermore the host country must have social capabilities, such as a sound education and legal system (UN ECE, p187, 2001). In addition the nature of FDI may affect the magnitude of spillovers, as export orientated FDI bring less potential spillovers than if orientated to the domestic market (Radosevic, p113).

¹ This chapter draws upon research carried out with Professors. Mike Wright, Igor Filatotchev and Trevor Buck. Many thanks to them for allowing me to use this research in my PhD.

² Of course it is accepted that foreign ownership can bring several problems to the host economy, such as dualism, the crowding out of indigenous entrepreneurship, see Thirlwall (p401, 1999). The UN ECE 2001 also documents some negative aspects of FDI: foreign owned enterprises may provide affiliates with too few or the wrong kind of technology, or limit access to technology, or it may limit downstream producers to low value added activities, reducing the scope for technology transfer (p187).

³ In a similar manner to Aitken *et al.*, (1997) we shall assume that a firm with positive foreign equity can be termed a multinational enterprise, or a recipient of FDI.

⁴ Positive spillovers may occur in the local economy through linkages with local suppliers, the creation of competition, training and imitation (UNE, ECE, p185, 2001).

⁵ Defined as the *“ability to identify, assimilate and exploit outsider knowledge,”* Damijan *et al.*, (2001), p6. Blömmstrom and Sjöholm (1999) also assume that the magnitude of the effects of FDI depend on characteristics of the host country and industry and policy environment (p916).

In fact there is empirical evidence to show that foreign ownership of firms (not necessarily wholly foreign owned entities) are positively associated with exporting activity, and although this may not produce such prolific spillovers, the impact on the trade balance should be positive⁶.

One example in the literature is Willmore (1992) who finds that transnational firms in Brazil, “*export more than otherwise comparable Brazilian firms,*” (p314), as these foreign owned firms have links to other countries, making it profitable to export.

Similarly, Aitken *et al.*, (1997) test the hypothesis that multinational enterprises act as an export catalyst in Mexico. With a panel dataset and by employing probit regression he finds evidence to support this hypothesis. Thus the probability of being an exporter is correlated with the local concentration of MNE activity, due to their superior knowledge of foreign markets and ability to attract specialised input suppliers.

Lastly, my research documented in the previous chapter has shown that foreign ownership is positively associated with exporting activity in Russia, Ukraine and Belarus.

Co (2001) examines the impact of foreign investment upon industry price-cost margins (PCM) in the US. She proposes that FDI may lower the PCM as it may increase domestic capacity and production (assuming that incumbents do not exit the market). In a transition context, this may lead to an increase in competition, yet could lead to bankruptcy for those firms unready to face such strong competition.

Conversely, FDI may increase PCMs if the entrant firm brings or adopts sophisticated technologies. By using two stage least squares to control for possible endogeneity⁷ Co finds that both greenfield and non greenfield FDI augments PCM, with a lag, as it takes time for incumbents to “*learn technology that they have acquired,*” (p179). In the transition economies FDI may cause PCMs to rise if the entrant firm brings new technology to the host market, which local firms can adopt (with a time lag). Thus this maybe another channel which FDI can benefit the local economy, furthermore if FDI does *lower* PCMs this may accelerate the restructuring process in transition economies.

Damijan *et al.*, (2001) employ endogenous growth theory by assuming that knowledge is a determinant of growth, and that new knowledge is essential for transition economies to catch up with the EU. They study the effects of FDI on technology transfer in eight transition economies, and hypothesise that the presence of transnational companies (TNCs) is one channel for transition

⁶ Assuming that the firm has an export/import ratio of greater than 1.

⁷ Co (2001) also controls for industry concentration as it is hypothesised that margins are higher in more

economies to catch up, via spillovers. For example, they claim that “*FDI is potentially the most important vehicle of technology transfer for firms,*” as it allows them to restructure quickly, imposes an efficient corporate governance system and even create positive spillovers to local firms (p6).

By using a large panel dataset (1994-8) and a growth accounting approach they find that FDI is an important channel for technology transfer in Czech Republic, Estonia, Poland, Romania and Slovenia. In addition, they also find evidence of intra -industry spillovers in Romania.

Blömstrom and Sjöholm (1999) also test for the evidence of spillovers in Indonesian firms. Using data from 13,663 firms, and 329 industries they find that foreign ownership is positively and significantly related to labour productivity, and also leads to intra industry spillovers. However, when they add two dummy variables for minority and majority foreign ownership they find that the *degree* of foreign ownership has no impact upon labour productivity and intra industry spillovers.

Chhiber and Majumdar (1999) examine the impact of foreign ownership and firm performance in India, whereby they state a common hypothesis in the foreign investment literature, “*firms in which there is a higher share of foreign ownership will on average perform better than their domestic counterparts,*” (p210). However, Chhiber and Majumdar extend this by adopting the ownership concentration literature by Demsetz and Lehn (1985) and hypothesising that in Indian firms, where foreign owners have a 51% shareholding will display superior performance relative to other firms (p214).

Their results confirm this, firms with “high”⁸ levels of foreign ownership are positively correlated with both return on sales and return on assets⁹. Thus at higher levels of foreign ownership “*capabilities that help generate superior performance are likely to be supplied,*” (p227). Furthermore, they find that foreign ownership brings other benefits such as higher wages, higher export growth rates and faster asset turnover ratios, bringing welfare benefits and reinvestment opportunities (p232).

Borensztein *et al.*, (1995) assume a more macroeconomic approach when examining the benefits of FDI, by exploring the role of FDI in economic growth, from industrial economies to 69 countries in the developing world. They state that FDI may be responsible for growth as multinational companies

concentrated industries.

⁸ Chhiber and Majumdar use three dummy variables, low, medium and high degrees of foreign ownership.

⁹ Interestingly, Blomström and Sjöholm (1999) find that the degree of foreign ownership does not affect the level of labour productivity or spillovers in foreign establishments in Indonesia.

are some of the most technologically advanced, and are responsible for a large fraction of the world's research and development.

By using data from the OECD from 1970-1989 they find that FDI has a significant and positive effect upon economic growth, and the level of overall investment, due to complementarities between foreign and domestic production. However, these relationships depend upon a threshold on the level of educational attainment being met, which is assumed will boost the absorptive capacity of the host country.

Barrell and Pain (1999) also stress that FDI may affect the economic growth of economies, as *“inward investment is ...a channel through which new ideas, working practices and technologies can arrive in host economies,”* (p931). They use panel data techniques to analyse the impact of economy wide inward investment on technological change in the UK, France, Germany and The Netherlands. Their principal results show the benefits of FDI: an increase in the real stock of inward investment is shown to raise the level of technological progress which implies that FDI does affect the pace of economic growth.

The UN ECE, 2001, also states that FDI can be expected to generate growth endogenously, their analysis of transition economies shows that there is a positive relationship between FDI and economic growth. For example, in Hungary FDI driven export growth appears to be responsible for the improvement of economic performance in the latter part of the 1990's.

Haskel *et al.*, (2001) focus on whether domestic owned firms are more productive when foreign owned plants are present in the domestic firm's region or industry. With their dataset which spans the entire manufacturing industry in the UK from 1973-1992¹⁰ they estimate a wide range of specifications of a production function for domestic plants, augmented for foreign presence (in industry and region) and controls (such as product competition). Their results consistently showed a positive correlation between domestic plants' total factor productivity and the foreign owned share of activity in that plants' industry¹¹. Haskel *et al.*, also highlight the importance of the absorptive capacity and attempt to augment their specifications with a proxy, such as employment and skill intensity (see p19, for more details).

McMillan (1993) assumes a more qualitative approach when examining the benefits of FDI. He notes that foreign ownership creates pressure on the domestic country to build institutions such as

¹⁰ This large time series allows them to use lags to correct for possible endogeneity (p11).

¹¹ Results were positive, but less significant for foreign owned share of activity by region.

financial services and accountancy norms. The existence of these institutions create positive spillovers for domestic firms, as they will also benefit from the availability of financial services etc. Thus, considering that the presence of foreign ownership or a foreign partner can bring several advantages¹² to the local economy and host firm, the determinants of foreign partner presence should be studied for policy purposes.

Furthermore, foreign partner selection is crucial for IJV success. As we saw in chapter two Koot (1988) states that foreign partner selection is a crucial procedure which contributes to the success or failure of the international joint venture. Given that Banai (1999) notes that the failure rate of international joint ventures in Russia is high, this becomes an even more pressing research topic.

A SPECIAL ISSUE: THE ENDOGENEITY OF OWNERSHIP

Demsetz and Lehn (1985) and Demsetz and Villalonga (2001) provide empirical evidence showing that ownership structure is endogenous and determined by firm specific factors and past firm performance by using two stage least squares regression.

Bishop *et al.*, (2001) in light of these findings argue that the equity structure in the largest Hungarian firms should not be treated exogenously. As they note much of research on the economics of transition has developed and tested models describing the impact of corporate governance structure on firm performance. However existing empirical studies have found conflicting results, which may indicate that the underlying theoretical assumptions are flawed. Thus Filatotchev and Mickiewicz (2001) claim that ownership structure maybe an outcome of firm specific factors, such as size, performance and industry structure. Yet, so far this is rarely accounted for in transition economics research

For example, Djankov and Murrell (2002) note in their meta analysis of studies on ownership and economic restructuring that simultaneous causation may exist (p12), yet only 53% of studies analyzed, accounted for selection bias. Carlin *et al.*, (2001) warn that they were unable to implement corrective procedures and van Winbergen and Marcinell (1997) find that selection into Czechoslovakia's voucher programme was non random, and should be accounted for when analysing the impact of voucher programmes on outcomes.

¹² Assuming the host economy has the absorptive capacity to benefit from spillovers and the technology gap between the host and entrant is not too large (Radosevic, p113, 1999).

Only a rare study by Aukotsionek *et al.*, (1998) of 150 privatised firms in Russia shows that selection bias exists as outsiders buy shares of relatively successful firms. Similarly, Damijan *et al.*, (2001) note that transnational companies tend to acquire more capital and skill intensive firms in Slovenia, while in Estonia export orientated firms are preferred by TNCs.

Thus in this chapter ownership shall be treated endogenously, or more specifically the presence of a foreign partner shall be treated as an endogenous variable.

There are parallels with this chapter and the research by Bishop *et al.*, (2001) who explore the determinants of equity shares held by foreign investors¹³ in Hungarian firms. Bishop *et al.*, use independent variables such as firms size, export intensity, performance and industry affiliation to determine the level of equity held by foreign investors. This chapter also uses firm size and export activity, managerial perceptions and other firm specific characteristics, such as level of investment required for modernisation.

6.2 FOREIGN PARTNERS IN THE FORMER SOVIET UNION

At first sight, emerging economies starting to generate positive income growth, offer major opportunities for business (Hoskisson *et al.*, 2000). Certainly, the break-up of the Former Soviet Union (FSU) and the subsequent liberalization of former State socialist economies, facilitating *transitions* to market-dominated systems, open the way for firms from developed countries to enter these markets. The GDP of these countries is unarguably significant. For the three main industrial economies of the FSU countries examined here, official GDP in 1997 was equivalent to US\$631 billion for Russia, US\$110 billion for Ukraine and US\$13 billion for Belarus, and unofficial incomes add to these totals.

However, emerging economies are quite heterogeneous, involving both countries that had previously been undeveloped as well as those adapting from communism (Hoskisson *et al.*, 2000). This heterogeneity introduces different problems and prospects regarding the links with foreign partners. Unlike the emerging economies of Latin America and South East Asia, growth rates in the non-Baltic countries of the FSU have until recently been low and even negative. The average annual growth rate in GDP between 1990 and 1997 in Russia, Ukraine and Belarus was -7.7%, -13.1%

and -4%, respectively. In this sense, many of the republics of the FSU may be accurately described as transitional economies, but also “non-emerging” to date.

The legacy of central planning continues to pose major problems for enterprises seeking to become commercially viable in a market economy. Economic reforms, including liberalization and privatization, were intended to promote global integration across all sectors of the FSU. However, industrial sectors have experienced different degrees of competition and/or demand collapse, and different exposure to, and opportunities for, internationalisation. In addition, even within a particular region, the progress of different countries in transition generally (Estrin & Wright, 1999) and towards the development of links with foreign partners in particular may be heterogeneous. This heterogeneity needs to be understood by both international executives and researchers because of its implications for foreign firm entry strategies.

Enterprise restructuring in Russia, Ukraine and Belarus may be affected by different contextual factors since the three countries followed different paths to transition (Filatotchev *et al.*, 1999b). Although each country has a common institutional background as part of the FSU, and each has employed centralised privatisation programs using vouchers distributed freely to citizens, in practice reforms have been slower and shallower in Belarus and Ukraine than in Russia. In Russia, managers are exposed to hardening budget constraints in a substantially liberalized market environment (Filatotchev *et al.*, 1996) whereas the reform process in Belarus has been very slow. The Ukrainian economy is somewhere in between these two extremes, with the government using a mixture of ‘stop-go’ policies in relation to market reforms. Moreover, the privatisation process in the three countries also differed, with Belarus focusing on a smaller set of more attractive larger enterprises while in Russia the process was more widespread.

High country risks and low asset productivity have characterized each of these countries. Not surprisingly, foreign direct investment as a proportion of GDP remains well below the levels seen in Latin America and South East Asia at 1.4 per cent in Russia, 0.6 per cent in Ukraine and 1.4 per cent in Belarus. Despite these difficulties, real opportunities for partnerships with enterprises undoubtedly exist given the potential size of the market, low costs of production, the proximity of Western markets, etc. (McCarthy *et al.*, 2000). The key issue is to identify the opportunities. This chapter, therefore, explores the scope for the development of links between local enterprises and foreign partners in three countries from the FSU, Russia, Ukraine and Belarus. After this

¹³ They also determine the equity shares held by domestic institutional investors.

introduction in which the main research questions are posed, it begins with a short review of the transition context of the FSU, followed by a consideration of the role that institutional theory may have in its comprehension. This chapter then utilizes this institutional lens to focus on the importance of strategic alliances to the FSU, and considers the key role of *partner presence* by local firms and foreign investors. Some significant findings are presented from successive surveys of actual partner presence in Russia, Ukraine and Belarus, and finally there is a discussion of important conclusions. The research builds on a significant body of literature on the extensive development of strategic alliances and joint ventures between enterprises, particularly in transitional economies (Brouthers & Bamossy, 1997). Partner presence is an important but not yet well understood aspect of alliances in particular and of internationalization in general (Inkpen & Beamish, 1997). Research suggests that partner presence is an important ingredient for the success of alliances between foreign and local firms. Partners may, in general, be admitted because they bring much needed resources to enterprises (Barkema, Bell & Pennings, 1996), but previous research on foreign partners has been mainly focused on the perspective of the developed country partner (Peng, 2000; Kotabe *et al.*, 2000), with little consideration of local partners in would-be emerging economies. A recent exception is provided however by Hitt *et al.*, (2000), who use resource-based and organizational learning theories to analyze partner presence in a sample of emerging countries that includes the transition cases of Poland and Romania. However, their main focus is on comparing the general economic contexts of developed versus emerging markets. The addition here of three “non-emerging”, yet transition countries from the FSU arguably provides a more balanced and complete picture and, by considering differences between countries, emphasizes the need to understand the heterogeneity of the transition phenomenon.

It seems important therefore to extend this analysis to the FSU and to consider, in the context of major institutional changes, the relevance of institutional theory, albeit with implications for other theoretical approaches to partner presence, i.e. for company resources and organizational learning (Hitt *et al.*, 2000). In addition to a lack of emphasis on institutions, a focus on non-local partners and a neglect of the FSU, previous research has also been concerned primarily with cases of successful partnerships and subsequent alliances actually implemented. To complete the picture, in the context of the “non-emerging” countries of the FSU, it seems equally important to analyze why partners are *not* selected, and thus alliances not consummated. Understanding these issues may be

of crucial importance since failure to address institutional impediments may lead to a decline the extent of links with foreign partners rather than an anticipated increase.

In the unique institutional circumstances of the FSU, it is therefore proposed that (i) the perceptions of local managers in relation to potential foreign partners and (ii) how local managers *believe* that foreigners perceive local firms as partners, can be as important as actual local/foreign perceptions of each other in the determination of actual alliance formation. For example, search and deliberation processes are found to be quite different for local and multinational firms and contribute to 'psychic distance' between firms and inertia (Rangan, 2000). Throughout this study, four main research questions are posed in the context of three former republics of the FSU. The first requires a descriptive response: to what extent have partnerships occurred? The second is more analytical and asks, what are the most feasible explanations for the presence and non-presence of partners? If alliance formation in the FSU is shown to be inadequate, the answer to this second question should give clues for the design of actions aimed to make an improvement. Thirdly, I determine which factors influence retained foreign partner presence, and lastly factors determining a firm gaining a foreign partner over a two year period¹⁴. A final, discussion section draws attention to the implications of our study for partners in developed and transitional economies.

6.3 INSTITUTIONS IN TRANSITIONAL ECONOMIES

While the resource-based view of the firm and organizational learning may be the appropriate base for the analysis of foreign partner presence in emerging economies (Hitt *et al.*, 2000), massive institutional changes in the FSU since 1991 and the inheritance of formal and informal constraints from the past emphasizes the need to adopt an institutional perspective here. This approach is built on the notion of an institutional framework comprising a fundamental set of formal and informal rules that govern and constrain production, exchange and distribution (Davis & North, 1971). Formal constraints include economic contracts and political and judicial decisions, while informal constraints cover codes of conduct and norms of behavior that are socially sanctioned (Peng, 2000). While national culture undoubtedly plays a role in this social sanctioning, it can be argued that the individuals and groups who hold power within an economy influence institutional systems of

¹⁴ These may also be important research questions as a significant number of firms experience a loss of a foreign partner from 1996-1997 (see table two).

education, social provision etc. that conform with national culture yet reinforce their own positions. In this sense, culture and institutions interact and it is not meaningful to employ an analysis that treats them separately (Buck *et al.*, 2000).

It is controversial to describe the pre-reform Soviet Union as a “centrally-planned” economy, since plans were ignored when ministers, enterprise incumbents and others colluded to simulate the achievement of planned targets. In addition the operation of an unplanned, informal sector and networks were vital to industrial output. Nevertheless the old institutions mainly comprised a system in which principals (in ministries and branch ministries) announced output targets to their agents in industrial enterprises, and applied rewards and penalties for achievement and non-achievement. Such a system was supported in the FSU by national cultures characterized by high tolerance of power-distance and high uncertainty-avoidance (Naumov, 1996).

Within this framework, employees enjoyed negligible levels of unemployment (outside the enterprise at least) and relatively generous welfare facilities, mainly provided through enterprises. Large investments were centrally financed in line with planned priorities, while innovations were risky for enterprises in the sense that they threatened the achievement of output targets; most innovations were developed in central research institutes and imposed on reluctant enterprises.

The existence of “soft budget constraints” (Kornai, 1998) under State socialism in the FSU meant wasted resources within enterprises, and a shortfall of intensive growth. Problems with coordination and incentives ultimately made deep, market-based reforms necessary in the FSU, but employees and managers feared increased uncertainties, leading in the post-reform period to the manager-controlled, employee-owned privatized firms alluded to earlier.

Institutional theory is an important lens through which to view the problems of post-reform enterprises of the FSU (Hoskisson *et al.*, 2000). For example, Newman (2000) explains that, as with individuals subjected to ever-increasing environmental uncertainty and stress, firms can be exposed to too much change. With deep, simultaneous and repeated institutional upheavals, organizational learning and the search for the appropriate organizational template by firms becomes impossible, and the extent of a firm’s embeddedness in the old institutions may become a key to enterprise survival. Alignments with old template norms may continue where new norms cannot be perceived, and firms continue to focus on domestic markets with existing products, ignoring new technologies and structures. Foreign investors are now perceived as threats rather than opportunities, but, in any case, (Peng, 2000) foreign investors are discouraged by an institutional

environment featuring the non-enforcement of private property rights, a lack of political stability, high country risks and an absence of strategic factor markets, especially markets for finance.

Each of these formal constraints on enterprise reform can be attributed to the entrenched institutional positioning of enterprise and ministerial employees, and informal constraints may be imposed by network contacts carried over from the old regime (Peng 2000). In addition, a culture of uncertainty-avoidance, high power-distance and local collectivism (1996) and associated institutions (e.g. insider ownership of firms) may create great *distrust* of non-local partners, especially foreigners.

In these circumstances, it is important to make empirical surveys of privatized firms, with particular reference to important strategic decisions concerning partner presence, and to the few cases in the FSU of successful partnerships and alliance formation in the face of institutional discouragement.

6.4 POST-TRANSITION FOREIGN PARTNERS IN THE FSU

With institutional barriers to direct exporting to the FSU and the cheapness of local factors, entry modes with higher levels of commitment by foreign investors become attractive (Leonidou & Katsikeas, 1996). However, enterprise incumbents, justifiably fearing the loss of short-term job security and social provisions following foreign acquisition, are likely to demand job guarantees and the sale of firms as complete entities, including the social liabilities that are a major institutional feature of privatized firms in the FSU. On the other hand, high country risks in the context of under-developed legal structures and enforcement are likely to force foreign investors to consider entry modes with lower levels of commitment. Where high foreign costs deter direct exports, alliances in the forms of strategic cooperation and equity-based joint ventures, lying somewhere between direct exports and the acquisition of complete firms, now assume greater importance, and impose important demands on partner acquisition.

For potential foreign entrants, it is necessary to identify the kind of local firms that may be potential partners. The rest of this section develops arguments suggesting that the nature of foreign partner links will be influenced by institutional echoes of the old regime (embodying cultural influences), by factors relating to local managers' perceptions of what foreign partners are seeking and the resources they bring, local enterprise strategies and the governance of local enterprises. As a novel feature of this study, we seek to distinguish between the views of managers of enterprises both with and without foreign partners. In the sections that follow, possible influences on the extent of

partnerships are considered with reference to (a) how local firms perceive themselves to be seen by potential foreign partners, and (b) the possible resource contributions of foreign partners. Since actual partnerships are likely to depend on both local firm strategies and the incentives offered to local managers after privatisation, subsequent sections consider (c) firms' strategies towards foreign markets and (d) corporate governance. Each of these elements is analysed in relation to two main research questions posed concerning levels of foreign partner presence and their determination.

6.4B¹⁵ Foreign Partners' Perceived Objectives and Local Firm Attractiveness

It seems likely that institutional influences on local firms to resist change will give them objectives diametrically opposed to those of potential foreign partners. These differences may be magnified by prevailing institutions that encourage local firms to perceive incompatible objectives in foreigners. Studies of the objectives of local firms and of outside investors in alliances elsewhere in transition economies have already identified such conflict (Hoon-Halbauer, 1999). Foreign partners are typically motivated by saturated home product markets and the need to establish a "bridge-head" in potential, previously isolated, foreign markets. In contrast, local firms, forced by the prevailing institutions of State socialism to focus on secure domestic markets, are usually anxious to improve technological levels in terms of new products and processes designed to secure export sales. Subsequently, local partners have often been disillusioned by an inability to export and by low levels of local procurement, as foreign partners protect employment levels at home (Buck, Filatotchev, Demina & Wright, 2000).

In Russia, Fey (1995) similarly reported diametrically opposed objectives for local and foreign partners. The most frequently cited reasons by local partners for JV formation were access to export markets and inward transfers of capital and technical expertise¹⁶. On the other hand, these objectives were not once cited as important by foreign partners, who emphasised access to local product markets and cheap labour. Such conflict of objectives may add to the distrust of foreigners inherent in an institutional and cultural environment where local solidarity in the face of distant authority has always created low levels of trust.

Where trust is tolerably high, foreign firms have a number of potential entry modes into foreign markets, with entry already explained as progressing through a number of stages from low to high

¹⁵ Of course it is accepted that the presence of a foreign partner may alter the perceptions' of a firm, concerning their objectives, however here, it was decided that foreign partner presence is treated as the endogenous factor.

commitment (Leonidou & Katsikeas, 1996). Foreign firms may seek partnerships with local firms in order to establish themselves as local producers in the market before competition arrives (Luo & Peng, 1998). A local partner can offer incumbent advantages as a result of institutions carried over from the old regime, e.g. relating to local information, political contacts, distribution networks, customer bases, etc. Foreign firms may thus be perceived as being interested in developing local production through partnerships with local enterprises. There may, however, be a number of reasons why potential foreign partners are perceived to be seeking to acquire local firms in order to close capacity and thus remove competition. Local enterprises may have a customer base but their equipment may be outdated and require considerable investment to become viable. Outdated technology could also be easily overtaken by later entrants with access to newer technology. The asymmetry of objectives between foreign and local enterprises may also be a rationale for acquiring local enterprises and closing capacity (Beamish, 1985). Foreign entrants may be seeking to maximise the benefits from transferring technology to local markets while local enterprises are seeking to obtain benefits from acquiring this technology and using it in other contexts, some of which may involve competition with the foreign firm. Given the institutional environment of the FSU that placed little emphasis on individual property rights, and the associated difficulties in obtaining influence with a minority equity holding, acquisition may be important to exert some form of control over the relationship (Peng, 2001); alternatively, a minority relationship with a local partner may be a stepping-stone to eventual full acquisition (Filatotchev *et al.*, 1996).

Local managers may perceive they are able to meet foreign partners' needs for access to their knowledge of local conditions and networks inherited from the old regime (Peng & Heath, 1996). However, foreign firms may place relatively little emphasis on the technology of local enterprises or local managers' technical expertise since in the changing market conditions involved in transition, local managers' past local knowledge and decision template may be of little relevance.

Managers and employees of local firms are embedded in, and dependent upon, social institutions inherited from the FSU whereby firms themselves provide a wide range of social benefits as well as incomes. These benefits are of course recognised as financial liabilities by western investors. Such liabilities, and other factors, may mean that managers of local enterprises do not perceive their enterprises as being attractive to potential foreign partners. Similarly, long-established management may be hostile to outsiders who are perceived to threaten their positions. Although employees may

¹⁶ This forms the basis for H5 and H6.

be technically well-educated as a result of Soviet institutions, where most strategic decisions were made centrally within ministries, these skills may not be highly valued with a new commercial environment and more advanced technology.

The Soviet inheritance was of giant, vertically-integrated industrial firms now requiring large investments to approach global standards of product design and build, and these two factors (size and required investments) may also reduce the value of local firms to foreigners. A particular problem in the FSU also concerns the costs of rectifying the consequences of decades of pollution.

This section provides us with the following controls and hypotheses:

Control 1: firm size decreases the likelihood of a firm having a foreign partner.

Control 2: required investment increases the likelihood of a firm having a foreign partner.

We also control for country effects and therefore include a dummy variable for Russia and Ukraine, while Belarus is our control¹⁷.

H1: perceptions that foreign partners are seeking access to local markets via local production are positively associated with the likelihood of a firm having a foreign partner.

H2: perceptions that foreign partners are seeking access to local technology are negatively associated with the likelihood of a firm having a foreign partner.

6.4C Perceived Resource Contributions of Foreign Partners¹⁵

Kotabe *et al.*, (2000) examine the motivations for seeking partners from the perspective of local Latin American enterprises and argue that foreign firms seeking entry into Latin America via a partnership with local firms need to address why local firms are motivated to collaborate. They find that access to technical expertise, marketing expertise, financial resources, foreign markets, risk and cost reduction and competitive markets are the most important factors. The legacy of central planning institutions in the FSU was that for many privatised enterprises, equipment was outdated and inefficient, producing inferior finished goods (Linz, 1996). The voucher privatization programs in FSU noted above did not introduce significant additional finance to enable firms to invest. This was because firms were essentially “given away” in exchange for citizens’ vouchers and hence negligible funds changed hands. Under-capitalised banks, weak capital markets and a central government without funds meant that capital was not available to enable firms to invest in new plant and

¹⁷ This is following existing work by the University of Nottingham, which uses Belarus as the control. However it is accepted in the literature that the country with the largest number of observations should be the numeraire.

equipment (Newman, 2000). The financial infrastructure has also been slow to develop since privatisation, so that access to funds for investment is also heavily restricted (EBRD, 1998).

Enterprises may thus perceive that foreign partners bring the resources required to renew existing equipment unavailable in domestic capital markets.

The lack of investment in FSU enterprises is also likely to mean that technology is outdated both for existing products and new products. Even in military-industrial-complex enterprises, which, as a high-priority sector, received significant amounts of capital investment under the previous regime, there may be a major need for access to new technology that is appropriate to the production of commercial goods (Filatotchev *et al.*, 1993). Foreign partners may thus be seen as sources of financial resources to invest in new technology as well as bringing technological know-how (Gillespie & Teege, 1995).

In the environment of the FSU, firms were guaranteed markets for their output, in the FSU and in the rest of CMEA. However, the break-up of the FSU after 1991 generally exposed firms in manufacturing industries to a massive collapse in demand. In these new circumstances, FSU firms may seek foreign partners in order to provide access to new markets. Access to new markets outside the FSU may be achieved through either direct or indirect exporting, the latter being undertaken by outside export intermediaries (Peng, 2000). This is a potentially important and distinctive issue in FSU since most firms with export experience under central planning would export through State trading companies that did not allow direct contact with overseas customers.

However, alliances between developed market firms and emerging market firms are typically focused on developing the latter's local markets (Hitt *et al.*, 2000), and the conflicting aims of local and foreign firms in relation to target markets may contribute to the erosion of mutual trust, and already damaged by different institutional and cultural inheritances, but so vital to the success of all alliances (Fey, 1995).

The education system in the FSU is generally considered to have produced highly technically competent outputs. However, these skills may not be effective in situations that are not stable and predictable (Shama, 1993). Further, the centralised institutions of State socialism meant that the capabilities of managers in privatised enterprises were likely to be low in marketing, in finance on "hard" market terms or even in quality control (Filatotchev *et al.*, 1996; Lyles & Baird, 1994). Acquisition of these capabilities is important to enable management to compete both domestically and internationally. Foreign partners may thus be sought to provide managerial capabilities.

In addition to managers' perceptions about what foreigners are seeking and the resources they bring, a number of other factors relating to strategy and governance may influence the presence of a foreign partner.

This leads us to the next group of hypotheses:

H3: attitudes of firms in the former Soviet Union concerning access to technology from foreign partners is negatively associated with a firm having a foreign partner.

H4: attitudes of firms in the former Soviet Union concerning access to markets from foreign partners is positively associated with a firm having a foreign partner.

6.4D Exporting Strategy

In the FSU, strategic decisions to focus on domestic or export markets were made centrally, and exporting brought few direct benefits to the firm (Michaelopoulos & Drebensov, 1997). The presence of foreign partners may therefore be contingent upon managers' strategic priorities in the new environment, where exporting may at last be conducted by the firm itself rather than by central trade monopolies. Managers may now *try* to market existing products on world markets.

Landesmann (2000) highlights that export performance of firms is a signal of "*active restructuring*", and change in the behavioural response of the firm, this evidence of restructuring may well attract a foreign partner. Alternatively, innovation through product diversification and development may yield new products for export. A product development strategy that focuses on the needs of overseas markets is complex and difficult to implement, however, and may require foreign partners to provide necessary expertise and access. Risk-averse managers may opt for the less risky strategy of promoting existing products and developing new products for domestic markets (Hitt *et al.*, 1997). These approaches may have opposite effects on the presence of foreign partners.

The skills and knowledge necessary for successful involvement in export activities may be obtained through long-term relationships with foreign partners (Eriksson *et al.*, 1997). Foreign partners may also provide critical resources relevant to exporting otherwise unobtainable (Bonaccorsi, 1992).

Hooley *et al.*, (1996) find for Hungary that domestically owned firms without foreign partners were least likely to export. This may play a crucial role in the environment of the FSU, where direct foreign investment is currently the only feasible source of significant funding for former state owned enterprises (Filatotchev *et al.*, 2000). However, the willingness of enterprises to admit foreign

investors may be heavily influenced by their existing corporate governance and the incentives for managers that depend upon governance.

Therefore the following hypotheses are developed:

H5: managerial strategy geared towards domestic strategy is negatively associated with the likelihood of a firm having a foreign partner.

H6: exporting activity increases the likelihood of a firm having a foreign partner

6.4E Corporate governance

After 1991, manufacturing enterprise incumbents in the FSU represented a powerful political force, and they were able to influence the government's design of new institutions, especially in the form of privatisation programs. The subsequent voucher privatisation programs used in the three countries generally favoured insiders, and this degree of control may lead to entrenchment behaviour by insiders who may seek to resist restructuring strategies in privatised firms that have been described above as "employee-owned, manager-controlled" enterprises. They may resist downsizing of employment levels in the short term as there are few alternative employment opportunities (Filatotchev *et al.*, 1999), and insider control is associated with lower levels of exporting (Buck *et al.*, 2000a), this leads to the formation of H8, as foreign partners may be repelled characteristics of insider control.

Another manifestation of the institutional inheritance may be a reluctance to seek foreign partners. Where it has occurred, however, the influence of outsiders through ownership or board representation (Estrin & Wright, 1999) has been associated with strategic restructuring and may be more likely to lead to foreign partnerships.

Foreign partners also may seek firm with ownership structures which share their views on managerial monitoring and corporate strategy, therefore we arrive at H9.

Entrenchment behavior may be exacerbated by the existence of so-called 'Red Directors', i.e. those directors appointed under the former communist regime, who may be technically excellent but who have little experience of commercial activities (Filatotchev *et al.*, 1996). When these managers are replaced with more able and better trained managers there may be a more positive attitude towards outsiders (Barberis *et al.*, 1996). In addition, Warzynski (2001) find that managerial turnover leads to an increase in productivity in Ukraine Therefore, senior managerial turnover may increase the probability of having a foreign partner.

Bearing in mind these possible mechanisms concerning the perceived attractiveness of local firms, the potential contribution of foreign partners, exporting strategies and corporate governance, surveys were conducted to address the main research questions concerning the extent and determination of foreign partnerships, this brings us to the following hypotheses:

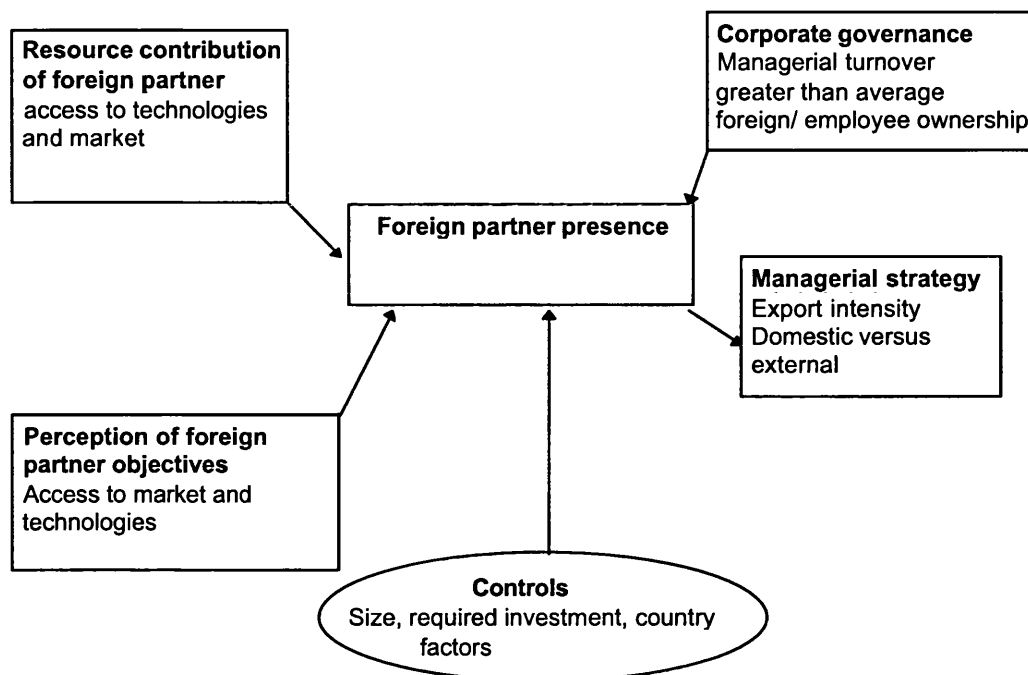
H7: managerial turnover is positively associated with the likelihood of a firm having a foreign partner.

H8: greater than average employee share holding is negatively associated with a firm having a foreign partner.

H9: greater than average foreign share holding is positively associated with a firm having a foreign partner.

This allows us to test the following model, shown in diagram one below¹⁸.

Diagram 1.



¹⁸ This model is also used in section 6.9 (gaining and retaining a foreign partner).

6.5 DESCRIPTIVE STATISTICS

Table 1: Firm characteristics¹⁹

	Russia	Ukraine	Belarus
Investment 1997	7994.65(44412.37)*	8265.92(16365.23)	2.43(11.61)
Investment 1996	5004.03(16065.78)	5214.44(8894)	0.84(2.5)
Export intensity 1997	3.37(9.5)	10.81(23.6)	6.56(17.29)
Export intensity 1996	2.12(9.5)	8.82(21.02)	3.21(0.3)
% of firms with a new director in 1997	35.2	28	2.0
% of firms with a new director in 1996	14	15	18
% of firms with greater than average foreign ownership ²⁰ in 1997	5	3	3
% of firms with greater than average foreign ownership in 1996	1	0	2
% of firms with greater than average employee ownership ²¹ in 1997	47	57	45
% of firms with greater than average employee ownership in 1996	33	60.	64

*Standard deviation in parentheses

The data were analysed using bivariate tests of differences between countries and over time, while logistic regressions were used to analyse factors affecting differences between enterprises with/without foreign partners, those enterprises which (did not) gain a foreign partner and those who (did not) retain a foreign partner.

6.6 RESULTS

This results section addresses the two main research questions outlined above, i.e. (i) what has been the extent of actual partner presence for strategic alliances and (ii) what are the most feasible explanations for the presence and non-presence of partners?

6.6 B Collaboration with Foreign Partners

In relation to research question (i), enterprises embedded in old institutional structures may be expected to be slow to respond to new opportunities that may be perceived as threats. Table 2 shows established links between privatized FSU enterprises and foreign partners are generally low.

¹⁹ For ownership descriptive statistics see Chapter 4 and Chapter 5.

²⁰ Defined as greater than 0.35% for 1995 and 0.94% for 1997

These levels are low in comparison with another transition economy like China (Buck *et al.*, 2000b) and also in comparison with the extent of links desired by local firms (Table 2). It is also evident that the extent of collaboration *has declined* over the two years (1996-97), suggesting inertia that is gaining ground. A high proportion of enterprises surveyed had foreign partners in 1996, but this too declined significantly by 1997. The share of firms with foreign partners fell significantly in Russia between the two years from an already low level. A significantly higher proportion of enterprises in Belarus was found to have a foreign partner, possibly reflecting the nature of the government program that involved the privatization of a small number of favored enterprises. However, it is clear that the most significant fall in the presence of foreign partners between the two years occurred in Belarus, reflecting the prevailing negative attitudes towards private business noted above.

Table 2: Extent of Established and Sought Links with Foreign Partners

	Established (%)		Seeking (%)	
	1996	1997	1996	1997
Russia	27	15*	56	28
Belarus	51	16***	63	61
Ukraine	24	24	71	60
All	34	18***	63	50

Sig. Levels: * = $p < 0.05$; *** = $p < 0.001$ and relates to Wilcoxon Z test between 1996 and 1997 for each country and for established partnerships and seeking links with foreign partners.

In terms of joint ventures, the form of alliance involving the highest level of commitment, a very small proportion of the sample (only 6 per cent) had a minority joint venture with a foreign partner and only 5 per cent had such a majority joint venture in 1996; these figures had fallen even further to 3 per cent and 0.3 per cent respectively by 1997. In Belarus, however, 13 per cent of the sample had minority joint ventures with foreign partners. Only one per cent of the sample held minority stakes in foreign firms abroad. Although most of the sample of FSU enterprises in 1997 had received visits from prospective foreign partners, the extent to which these visits have as yet resulted in firm relationships is relatively low.

The following sections analyse research question (ii), what are the most feasible explanations for the presence and non-presence of partners? Following the discussion above, the key issues are

²¹ Defined as greater than 64.5% in 1995 and 55.63% in 1997.

examined in terms of: foreign partners' perceived objectives and local firm attractiveness; perceived resource contributions of foreign partners; and the factors influencing the likelihood of having a foreign partner. As a result of the differing pace of institutional transformation in Russia, Ukraine and Belarus, significant differences are expected between the three countries.

6.6C Foreign Partners' Perceived Objectives and Local Firm Attractiveness

Despite a post-Soviet inheritance of obsolete machinery, commercially inexperienced managers and social obligations to employees, the majority of managers surveyed considered that their enterprise was attractive to a foreign partner, and therefore an influence on foreign partner acquisition.

However, mirroring our evidence that the extent of established and sought links has declined, the percentage of managers making this claim fell significantly between the two surveys from 69 per cent to 51 per cent. This may represent an improved awareness of commercial valuations. In the first survey, managers of enterprises in the Ukraine (79%) and Belarus (71%) were significantly more likely to take the view that their enterprises were attractive to foreign partners than was the case for Russian managers (56%). In the second survey undertaken in 1998, these figures had fallen to 66%, 49% and 39%, respectively. Managers considering their enterprise was attractive to a foreign partner perceived that foreign partners were principally seeking access to the local market through local production and through the acquisition and closure of local capacity (Table 3). Access to local technology and local managers' knowledge of local conditions were perceived as least important. This implies that FSU managers have become aware of the low values foreigners place on networks developed within the old institutional environment.

There were significant differences between the three countries, with access to local markets through local production being rated as significantly more important by managers in Russia than was the case in Belarus and Ukraine. Similarly, access to local markets through acquisition and closure of production capacity was significantly less important in Belarus. Managers in Ukraine in particular, were significantly more likely to hold the view that foreign partners were seeking to acquire assets at undervalued prices.

These results contribute to the existing literature on the objectives of local firms and foreign partners. While previous surveys reported above found that their objectives have in the past been in

fundamental conflict, the results here suggest that local firms have at least perceived this conflict correctly and are aware that foreign partners are mainly motivated by access to local markets.

Table 3: Local Firms' Perceptions of What Foreign Partners are Seeking

	Russia	Belarus	Ukraine	All
	1996	1996	1996	1996
Access to local market through local production	5.5 (1.9)	4.1 (2.5)	4.4 (2.4)	4.7 (2.4)*
Access to local market through acquisition & closure of production capacity	5.4 (1.8)	4.2 (2.4)	5.8 (1.8)	5.1 (2.1)**
Access to local Technology	3.3 (2.3)	1.9 (1.7)	2.4 (2.1)	2.5 (2.1)**
Access to local managers' knowledge of local conditions	1.7 (1.1)	2.1 (1.8)	3.1 (2.0)	2.3 (1.9)***
Acquisition of undervalued assets	2.8 (2.1)	3.7 (2.3)	4.7 (2.2)	3.7 (2.4) **
Preservation of former links	3.2 (1.7)	3.6 (2.4)	4.9 (2.1)	3.9 (2.4)***

Note: responses relate only to 1996, measured by 1-7 Likert scale; Sig. Levels: *** = $p < 0.001$; ** = $p < 0.01$, * = $p < 0.05$ and relate to Kruskal-Wallis tests of differences between all three countries on each variable. Standard deviation in parentheses.

For those cases where managers did *not* consider that the enterprise was attractive to foreign partners, the most important reasons, as scored by respondents across all three countries taken together, were the instability of consumer demand, the size of the investment that was necessary and the existence of more attractive companies in the same industry (Table 4). Perhaps surprisingly, ecological problems, shortcomings in the skills base, and majority control by employees were seen to be relatively unimportant factors.

There were some notable significant differences between the three countries with respect to the importance attached to each of these factors. For Russian enterprises the size of investment was significantly more important than for the other countries. For Belarus enterprises, the instability of consumer demand was significantly less important. For Ukrainian enterprises, the presence of more attractive enterprises in the same industry and shortcomings in the skills base were significantly more important.

Table 4: Local Firms' Perceptions of Why Enterprises are not Attractive to Foreign Partners

	Russia	Belarus	Ukraine	All
	1996	1996	1996	1996
Size of necessary investment	4.9 (2.3)	3.5 (2.4)	3.4 (2.3)	3.8 (2.4)*
Instability of consumer demand	4.7 (2.0)	3.2 (2.3)	4.9 (2.1)	4.3 (2.2)*
More attractive companies in same industry	4.1 (2.5)	2.7 (2.5)	5.3 (2.4)	4.0 (2.6)*
Management hostility to outsiders	1.8 (1.2)	2.1 (1.8)	1.8 (1.7)	1.9 (1.5)
Shortcoming of skills base	2.9 (1.5)	2.8 (2.2)	4.3 (2.3)	3.3 (2.0)*
Ecological problems	1.8 (1.5)	2.1 (1.7)	3.1 (2.5)	2.3 (1.9)

Note: scores based on Likert scale 1-7 where 1= very unimportant through 7= very important; Sig. Levels: * = $p < 0.05$; and relate to Kruskal-Wallis tests for difference between all three countries for each variable. Standard deviation in parentheses.

6.6 D Perceived Resource Contributions of Foreign Partners

Again, respondents seemed generally aware of the shortcomings of inherited technologies and resource capabilities. Across the enterprises surveyed as a whole, the most important resources that foreign partners were perceived as being able to bring were, in order of declining importance, rehabilitation of existing machinery, the introduction of new technology for new products, the introduction of new technology for existing products, access to foreign markets, training of managers in marketing, quality management, finance, etc., and general advice and consultancy (Table 5). Some notable significant differences between the countries were evident. Rehabilitation of existing machinery, access to foreign markets, general advice and training of managers being consistently significantly more important in Belarus and Ukraine than in Russia. New technology for existing products was significantly more important in Ukraine than in Russia.

There were also some indications that perceptions of the resources that foreign partners might bring were changing significantly over time. Across all enterprises in the three countries combined, the perception that foreign partners would bring new technology for new products was weakly significantly lower in 1997 than in 1996 while the reverse was the case in respect of the rehabilitation of existing machinery. There were some notable differences over time in individual countries. In Russia, the perceived contribution of foreign partners to bringing new technology for existing products and general advice were weakly significantly more important in 1997 than in 1996. In Belarus, the perceived contribution of foreign partners to bringing new technology for existing products and for new products was significantly less important (at 10% and 1% levels, respectively) over the two years of the study. In Ukraine, the perceived contribution of foreign partners to rehabilitation of existing machinery became significantly more important (at 1% level). These findings suggest a realisation over time on the part of managers in the three countries that foreign partners were unlikely to bring major new technological investment. This shift to a more realistic perspective was most marked in Belarus and Ukraine where, arguably, less progress in transition has occurred and where privatisation involved more of the respective countries major enterprises.

Table 5: Resources that Foreign Partners Might Contribute

	Russia		Belarus		Ukraine		All	
	1996	1997	1996	1997	1996	1997	1996	1997
New technology for existing products	5.1 (2.4)	5.4 (2.3)	5.8 (1.5)	5.4 (1.0)	5.9 (1.9)	5.8 (1.7)	5.5 (2.1)†	5.5 (1.9)
Rehabilitation of existing m/cry	5.0 (2.2)	5.1 (2.2)	6.1 (1.1)	6.1 (1.5)	5.9 (1.8)	6.4 (1.2)	5.6 (1.9) *	5.9 (1.7) ***
Training managers	3.9 (2.2)	4.2 (2.1)	4.7 (1.9)	4.6 (1.8)	4.9 (2.2)	5.6 (1.5)	4.5 (2.1) *	4.8 (1.8) ***
Access to foreign markets	4.9 (2.4)	4.3 (2.3)	5.8 (1.8)	5.5 (1.9)	5.6 2.1)	5.7 (1.8)	5.4 (2.2) †	5.2 (2.9) **
General advice	2.6 (1.8)	2.8 (1.9)	4.2 (2)	3.9 (1.9)	4.5 (2.2)	4.7 (2.1)	3.4 (2.2) ***	3.8 (2.2) ***

Note: Means of responses; responses were scored on a 1 -7-point Likert scale Standard deviations are in parentheses.

Sig. Levels: *** = $p < 0.001$, ** = $p < 0.01$, * = $p < 0.05$, † = $p < 0.1$ and relate to Kruskal-Wallis test between all three countries for each variable.

6.7 LIKELIHOOD OF HAVING A FOREIGN PARTNER

Perceptions about foreign firms' objectives and the resource contributions of foreign partners, together with enterprises' export orientation and the nature of the corporate governance regime influence the likelihood of enterprises being with/without foreign partners. Taking into account the effects of firm size, country of location and investment needs, this analysis provide indications of the extent to which firms are breaking free from the institutions of the past. The results are shown below in table 6 and table 6b.

Table 6: Factors Influencing Existence of Foreign Partner

The formal analysis of the factors distinguishing enterprises with and without foreign partners was conducted using the following logistic regression equations. Given the decline in incidence of foreign partners between the two years of the study, separate equations were run for each year.

Variable	1996	1997
Export/Sales (%)	0.1 *	0.04 ***
New Director	1.2 †	0.7
Employment ('000)	-0.08	-1.0 *
Required Investment ('000)	0.1 *	0.09 *
Perception that Foreign Partners Seeking Access to Local Markets Through Local Production	-0.2	N.a.
Perception that Foreign Partners Seeking Access to Local Technology	-0.4 *	N.a.
Looking for Foreign Partners to Gain Access to technology	0.02	-0.03
Looking for Foreign Partner to Gain Access to Markets	0.3 †	0.3 †
Directors Give Priority to Domestic market strategy	-0.4 *	0.03
Russia Dummy	1.8 *	-1.1
Ukraine Dummy	1.5	-0.7
Greater than average employee shareholding	0.6	-0.1
Greater than average foreign shareholding	11.9	4.2 **
Constant	12.4	-4.2 **
-2log likelihood	77.7	104.1
Chi square	49.4 ***	42.5 ***
% correct predictions	80.7	80.0
Hosmer & Lemeshow R ²	0.4	0.3
McFadden's R ²	0.6	0.4
N ^a	273	292

Notes: Sig. levels: *** p<0.001; **p<0.01; * p<0.05; † p<0.1 Dependent variable is existence or not of a foreign partner. Presence of a foreign partner was coded 1, while no foreign partner present was coded 0. Checks were made for the existence of multicollinearity problems; all VIFs were well below 10.

The analysis was carried out using several different definitions of the relevant variables, with this model producing the best specification.

^A A note on sample size; in this chapter the number of observations has increased, due to an increase in valid cases. Possibly this is due to the fact that respondents find it easier or are more willing to answer Likert scale questions, as opposed to detailed ownership structure, corporate governance or performance questions.

In addition, the data was pooled (see chapter three for a description of the technique and section 5.9 in chapter 5 for notes on pooling in this sample) and results are shown below.

Table 6b: Pooled results

Variable	Pooled specification
Export/Sales (%)	-0.04
New Director	1.32†
Employment ('000)	-0.8
Required Investment ('000)	-0.03
Perception that Foreign Partners Seeking Access to Local Markets Through Local Production	-0.07
Perception that Foreign Partners Seeking Access to Local Technology	0.07
Looking for Foreign Partners to Gain Access to technology	-0.03
Looking for Foreign Partner to Gain Access to Markets	0.16
Directors Give Priority to Domestic market strategy	0.13
Russia Dummy	1.01
Ukraine Dummy	0.91
Greater than average employee shareholding	2.12*
Greater than average foreign shareholding	4.38
Time dummy	0.32***
Constant	0.46**
-2log likelihood	54.34
Chi square	17.75
% correct predictions	71.15
Hosmer & Lemeshow R ²	0.23
McFadden's R ²	0.29
N	565

Notes: Sig. levels: *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; † $p < 0.1$ Dependent variable is existence or not of a foreign partner. Presence of a foreign partner was coded 1, while no foreign partner present was coded 0. Checks were made for the existence of multicollinearity problems; all VIFs were well below 10.

Firstly, in terms of strategic intentions and outcomes relating to exporting and differences in external versus domestically oriented product and market development were significant in differentiating between enterprises that had a foreign partner. In particular, where directors gave priority to seeking new domestic markets for existing products in 1996, enterprises were significantly less likely to have a foreign partner, supporting H5 (the relationship becomes insignificant in 1997, yet the sign of the coefficient is the same). Furthermore, we can accept with confidence H6 as the greater the percentage of sales exported, the greater the probability of having a foreign partner. This implies that existing exporters represent the firms that have broken away from the institutions of the past, and are more aware of the need for foreign partners. Clearly, actual exporting and foreign partners are not substitutes for each other. Bishop *et al.*, (2001) find similar results for Hungarian firms, where export intensity is also positively associated with the presence of foreign investors.

The perception among managers in FSU enterprises that potential foreign partners were seeking access to local technology significantly reduced the probability of having a foreign partner, in 1996, allowing us to accept H2. There was no significant association between the other perceptions noted in Table 3 concerning the objectives of foreign investors and the probability of having a foreign partner. Taken together, these results from H1 and H2 suggest that local firms have no illusions that foreigners are anxious to take advantage of human and physical assets inherited from the old regime. Technology transfer from the foreign partner to the host and vice versa may prove to be problematic, due to reasons of competition, as mentioned above.

Turning to the potential contributions of foreign partners, the perception that foreign partners could bring access to new markets was significantly more likely to be associated with having a foreign partner, allowing us to accept H4. The perception that foreign partners could bring access to new technology, managerial skills etc. were not significant in differentiating between the firms with and without foreign partners.

In terms of corporate governance, higher insider ownership and control potentially reflects stronger ties with the old regime, as management styles may adhere to the “Red Directors” fashion, but this was not significantly associated with the presence/absence of a foreign partner, so we cannot accept H8. There was evidence that the probability of a firm having a foreign partner increases when a firm

does have a greater than average foreign share-holding, allowing us to accept H9. This could indicate that foreign investors prefer a homogenous ownership structure, research by Bishop *et al.*, (2001) found similar findings: equity structures converge towards homogeneity.

Replacement of the chief executive is another important aspect of corporate governance. Indeed, changing the CEO was found to be significantly associated with having a foreign partner, i.e. the probability of having a foreign partner increases when a firm has had a new CEO, allowing us to accept H7. This suggests that CEO replacement is a significant proxy for a break with the old regime and a willingness to admit foreign partners.

In addition to the above factors, it is necessary to control for a number of firm-level and external factors. First, we take into account that firm size may affect the demand for, and supply of, foreign partners. Larger enterprises – a remnant of Soviet-era gigantism – may be both more outward looking and more attractive to foreign partners for reasons of economies of scale and scope. On the other hand, however, larger enterprises may be the problematical ‘dinosaur’ institutions left over from the old regime. (For differing perspectives on the impact of firms size see: Kotabe & Czinkota, 1992; Bonaccorsi, 1992.) We find that in 1997, size made firms less likely to attract foreign partners, perhaps implying that industrial “dinosaurs” are unappealing to foreign investors, this allows us to accept Control 1. This differs from the results of Bishop *et al.*, (2001) who find that size is positively associated with the presence of foreign investors in Hungary²².

Secondly, national political, cultural and social (i.e. “institutional”) environments (represented by country dummies) may influence strategic actions at a firm level, so we take into account that the presence for foreign partners may be affected by country-specific, systemic factors (Dominguez & Sequeira, 1993). In 1996, firms in Russia had significantly higher levels of foreign partner presence, probably indicating the more fundamental economic reforms in Russia compared with the more conservative Belarus and Ukraine.

Lastly, there was a significant positive relationship between the estimated amount required for modernising investment and the probability of having a foreign partner, allowing us to accept control 2. This suggests that firms with the greatest need for foreign partners successfully achieved more partnerships. In turn, this implies that foreign partnerships are constrained on the FSU side, and that a firm that breaks with the institutions of the past is able to find partners.

²² However, this positive relationship between size and the presence of a foreign partner does not exist when the percentage of equity held by foreigner is equal to 100.

Surveys of two consecutive years facilitate some comments on changes over time in reported associations, this may help to explain the reduced incidence of foreign partners noted earlier. For example, between the two years, size as measured by employment and above average foreign ownership become significant explanatory variables, while change of chief executive, location in Russia and directors' priority towards developing domestic markets become insignificant.

Lastly, a comment should be made on the R^2 statistic, Hosmer and Lemeshow's R^2 shows that the model can account for 30–40% of the variance in foreign partner presence.

The pooled results were disappointing with poor R^2 and classifications²³, however they reinforce one of the results found in table 6: the probability of a having a new director increases when a firm has had a new director, allowing us to accept H7. In addition, we have evidence to reject H8, as greater than average employee ownership is *positively* associated with a firm having a foreign partner, perhaps suggesting that foreign partners prefer a homogenous ownership structure, as opposed to diffuse ownership.

The results are summarised in the final section.

6.8 DISCUSSION

This study of managers in the FSU concerning their approaches to foreign partners has yielded important insights both for local managers and potential foreign partners. In contrast to much of the foreign partner literature that focuses on the selection of local partners by incoming firms, this chapter details one of the analyses to focus on foreign partners from local firm viewpoint. The need to examine the local firm's perspective is recently emphasised by Peng (2000), with Hitt *et al.*, (2000) also providing some evidence from the local firm perspective. An important and novel dimension of this research is to draw attention to the need to understand the heterogeneity of country experiences within the emerging market context. The study's findings have implications for both foreign partners and for local firms in transition economies.

²³ In order to test if the data could be poolable an additional specification was run, which included interactive slope coefficients, several of which were significant, suggesting that it may be more appropriate to adhere to single year equations in table 6. (See Gujarati, p645, 2001).

6.8 B Implications for Foreign Partners

The study shows that, although foreign partnerships are rare and ties with the old institutions of the FSU are strong, it is nevertheless possible to identify potentially attractive local partners. Potential entrants can increase the level of interest of local firms in Russia, Ukraine and Belarus especially by bringing resources that enhance technology, helping to renew equipment and providing access to markets. Kotabe, *et al.*, (2000), in respect of Latin America, and Buck *et al.*, (2000b), with regard to China, note the problems that can arise when partners bring only earlier-generation technology and equipment. Of course, investments involving the latest technology run the risk of technology leakage. This raises the important issue of the need to build trust in partner relationships where economic and political systems only recently were so different. The finding that local enterprises place considerable importance on the perception that prospective partners are looking to make acquisitions and close capacity implies a lack of trust about their motives.

While many enterprises in FSU are problematical, with entrenched managers who are reluctant to change, this is not always the case. There is also evidence that foreign firms have been able successfully to turnaround enterprises in the region (Meyer & Moller, 1998). Hence, foreign firms may find benefits in establishing trust with local enterprise managers. Of course trust depends largely on the harmony between partners' objectives and the evident conflicts that characterise JVs in the FSU indicate a need for frank and open discussions among potential partners before commitment to JVs, if their survival chances are to be high.

The finding of a fall in the extent of and search for foreign partners over time, amounting to a serious collapse, raises particularly important issues. This may be because local managers have become more realistic about the attractiveness of their business to potential foreign partners. Alternatively, the entrenched behaviour of local managers, in the style of the FSU, may have frightened-off potential foreign partners who may have been potentially interested in establishing a partnership. A further possibility is that foreign partners, after initially being interested, have decided that the business or the market is not attractive after all, i.e. that institutional change has been insufficiently deep. Further analysis is required to derive clearer policy recommendations for potential foreign entrants.

6.8 C Implications for Transition and Emerging Economies

Privatisation and foreign partner issues are important features of other transition and emerging economies but these economies are quite heterogeneous with respect to the importance of state-owned firms in the economy, economic growth/decline and success in internationalisation (Hoskisson *et al.*, 2000). Former centrally planned economies, where economic reforms have been unable to enforce well-defined property rights in the face of opponents of reform, may face quite different problems in establishing partner relations than is the case in emerging economies such as Brazil, India, etc. Similarly, the effects of demand collapse have generally been more severely felt in economies emerging from communism than in economies emerging from an undeveloped status, which have often experienced rapid growth. Clearly, there is a need for comparative studies involving enterprises in transition and emerging economies.

Overall, however, the trend observed towards a *reduction* in foreign partner presence across the three countries is quite alarming, and suggests that the patterns of power established under the old regime may not be dead yet. For this reason section 6.9 shall investigate the determinants of foreign partner presence over the *two year period* and determinants of a firm gaining a foreign partner, hopefully enriching and complementing the results presented in tables 6 and 6b.

Despite major institutional differences, the findings of this study indicate that the motivations of local enterprises in FSU for having foreign partners are similar to those identified by Kotabe *et al.*, (2000) in Latin America. However, while accessing technology and renewing equipment were found to be important resources, a principal distinguishing feature in FSU between enterprises with foreign partners and those where this was not the case was gaining access to new markets. Directors of enterprises in FSU who want to establish links with foreign partners need to be less focused on the domestic market. In order to achieve this shift in attitude it may be necessary to replace the chief executive with someone who is more open to internationalisation. The importance of the negative relationship between size and the presence of foreign partners suggests that developing relationships with foreign partners is likely to be problematical for the large “dinosaurs”, designed for survival in the environment of the former regime.

With respect to the heterogeneity of the markets, Russian managers appeared to be more realistic about the attractiveness of their enterprises to foreign partners and about what foreign partners might bring. There was some evidence, however, that managers in Belarus and Ukraine where, arguably,

less progress in transition has occurred and where privatization involved more of the respective countries major enterprises, were becoming more realistic in their expectations. The decline in the extent of established and sought foreign partner links also emphasizes this growing realism. The most significant fall in the presence of foreign partners found in Belarus, indicates a much more negative environment for foreign private business than is the case in Russia in particular.

Understanding foreign partners' objectives is crucial in preparing firms for collaboration (Dacin *et al.*, 1997). The need to address this problem is highlighted in this study, which makes a contribution to the literature by considering the whole analysis from the point of view of the local firm and by providing analysis of similarities and contrasts between countries from an initial common institutional starting point. The negative relationship between the presence of a foreign partner and a perception that potential foreign partners are seeking access to local technology suggests that many enterprises have unrealistic expectations in relation to their ability to attract foreign partners. Policy makers and advisors might usefully devote effort to enlightening local managers' perceptions. At the same time, international executives seeking to make links with local firms in these countries need to be aware of the attitudes of the managers with whom they may be negotiating and target environments that may be more receptive to these links.

6.9 Retaining and gaining a foreign partner

Many firms lost a foreign partner over the two year period; table two shows that the percentage of firms with an established link with a foreign partner fell from 34% in 1996 to 18% in 1997.

Therefore, it was decided to test hypotheses 1-9 on those firms which had retained a foreign partner *both in 1996 and 1997*.

Furthermore logistic regression was used to determine the factors which influenced whether a firm had managed to gain a foreign partner or not in 1997.

It will be interesting to see whether the same factors which influence foreign partner presence also influence whether a firm retains or gains a foreign partner

We start with some descriptive statistics.

Table 7: The extent of firms which gained/retained a foreign partner

	% of firms which retained a foreign partner	% of firms which gained a foreign partner
Russia	4.1	11.2
Ukraine	7.4	8.5
Belarus	9.0	8.0
Pearson Chi square	1.95 ^a	0.7 ^a
Cramer's V statistic	0.082 ^a	0.049 ^a

^a Insignificant statistic

Table seven shows:

- 1) the Chi square statistic, which detects whether there is a significant measure association between two dichotomous variables (here country status and retained/gained foreign partner presence), and
- 2) the Cramer's V statistic. This measures the strength of a statistical association between two categorical variables.

From the table above it is clear that there is no association between which country a firm is from and whether firms gained or retained a foreign partner, furthermore the Cramer's V shows that the strength of the association is very weak²⁴.

Following this, the two specifications seen in table six were estimated again, this time using two new dependent variables: (1) presence/non presence of a foreign partner in both 1996 and 1997, and (2) evidence of gaining a foreign partner in 1997. The results are shown below.

²⁴ Cramer's V is the more appropriate statistic, as one of the categorical variable has more than two categories

Table 8: regression results

Variable	Retaining a foreign partner in both years	Gaining a foreign partner in 1997
Export/Sales (%)	0.0009	0.02
New Director	0.12	1.12†
Employment ('000)	-3.12**	0.29
Required Investment ('000)	1.87**	0.39
Perception that Foreign Partners Seeking Access to Local Markets Through Local Production	-0.13	0.26†
Perception that Foreign Partners Seeking Access to Local Technology	0.11	-0.13
Looking for Foreign Partners to Gain Access to technology	-0.002	-0.003
Looking for Foreign Partner to Gain Access to Markets	0.0004	0.28†
Directors Give Priority to Domestic market strategy	-0.3†	0.29†
Russia Dummy	-0.79	1.02†
Ukraine Dummy	1.1	0.85
Greater than average employee shareholding	-0.51	1.39*
Greater than average foreign shareholding	0.32	3.35**
Constant	1.94	-4.63†
-2 log likelihood	121.89	159.06
Chi square	20.05†	35.542***
% correct predictions	93.16	90.6
Hosmer & Lemeshow R ²	0.16	0.22
N	292	292

(country membership), see Field (2000, p262).

Notes: Sig. levels: *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; † $p < 0$. Presence of a retained/gained foreign partner presence was coded 1, while non foreign partner presence was coded 0. Checks were made for the existence of multicollinearity problems; all VIFs were well below 10.

Beginning with retaining a foreign partner over the two year period we can see that there are several factors in common with the results shown in table six. For example, we can accept control 1 again, as firm size is negatively associated with retaining a foreign partner. This may suggest that foreign firms found strategic alliances more problematic with larger firms and therefore more likely to sever relations.

In addition we find that control 2 can be accepted again, as foreign partners are forming alliances with firms that require their presence the most, i.e. higher levels of required investment are positively associated with a firm retaining a foreign partner.

Lastly, we can see that managerial priority geared towards domestic market strategy is negatively associated with retaining a foreign partner, thus we can accept H5. This suggests that if a host firm continues to pursue a domestically orientated strategy foreign partners may break the established link.

Surprisingly, strategic outcomes (such as exporting), perceptions of foreign partner resource contributions, perceptions of foreign partner objectives and ownership structure do not significantly affect whether a foreign partner is retained.

By referring to the R^2 statistic and Chi square it is clear they are both low. In addition the Chi square statistic is not highly significant, thus the model does not predict very well if a firm has retained a foreign partner. For this reason section 6.9b shall include financial indicators and evidence of industrial restructuring in attempt to improve the model related to determinants of retaining foreign partner presence.

Next the factors which determine whether a firm gained a foreign partner in 1997 will be discussed. Beginning with foreign partner's perceived objectives, we can see that the perception that the foreign partner's objective to gain access to markets via local production is positively associated with a firm gaining a foreign partner, therefore we can accept H1. Similarly, we can accept H4 as the host firm seeking a foreign partner for access to markets is also positively associated with a firm gaining a foreign partner. This suggests that both the foreign partner and host firm are seeking a strategic alliance in order to gain access to foreign markets²⁵, this maybe a more feasible objective, as

²⁵ Interestingly, Banai *et al.*, (1995) finds that gaining access to foreign markets rates highly on the list of motives

compared to technology transfer²⁶. Although insignificant, the perception that a foreign partner is seeking local technology and the anticipated resource contribution to the host firm is access to new technology are both negatively associated with gaining a foreign partner. This suggests that technology transfer is problematic and therefore policy should focus upon the enforcement of property rights, contracts and trust. For example, Fey (1995) highlights that the transfer of technological expertise is a major source of conflict in Russian joint ventures, also local partners may have reason to not trust foreign partners if they are likely to close capacity (Beamish, 1985).

As opposed to results shown in Table 6, managerial strategy geared towards domestic markets is now *positively* (yet weakly) associated with gaining a foreign partner. This suggests that by 1997 potential foreign partners are possibly becoming more inward looking, and perhaps focusing on the possibility of servicing a large domestic market rather than use the host partner as an export platform, one reason for this could be difficulties in gaining export licences. This slight trend towards foreign partners being gained when managers focus on domestic market is reinforced by the fact that export intensity no longer significantly affects whether a firm gains a foreign partner.

As for ownership structure and managerial turnover these appear to be strong determinants of whether a firm has gained a foreign partner in 1997, perhaps suggesting that as foreign partners become increasingly aware of the importance these factors they place greater emphasis on this issue. Firstly, we can accept H7 as the presence of a new director positively affects whether a firm gained a foreign partner, reflecting that foreign partners are attracted to firms where “Red Directors” have been replaced, signifying a break from the old regime and old managerial skills and style.

Interestingly greater than average foreign *and* insider ownership positively affects whether a firm has gained a foreign partner, thus we must reject H8 but accept H9. From this we can infer that foreign partners prefer ownership structures to be dominated by similar groups of owners, as opposed to diffuse ownership structures²⁷, in anticipation of greater managerial monitoring. Hitt *et al.*, (1999) state that diffuse ownership produces weak monitoring of managerial decisions (p361), therefore potential foreign partners may seek firms with greater than average employee or foreign ownership, which although is not a measure of ownership concentration, this kind of ownership structure may

for entering a Russia-US joint venture (p23).

²⁶ Of course this assumes that the firm is not operating within a monopolistic industry, but given that the firms in this sample are not from typically monopolistic industries such as oil, gas or timber (Blasi *et al.*, 1997, p30) and that Brown *et al* (1994) found that few civilian manufacturing firms were monopolies, this assumption may be reasonable.

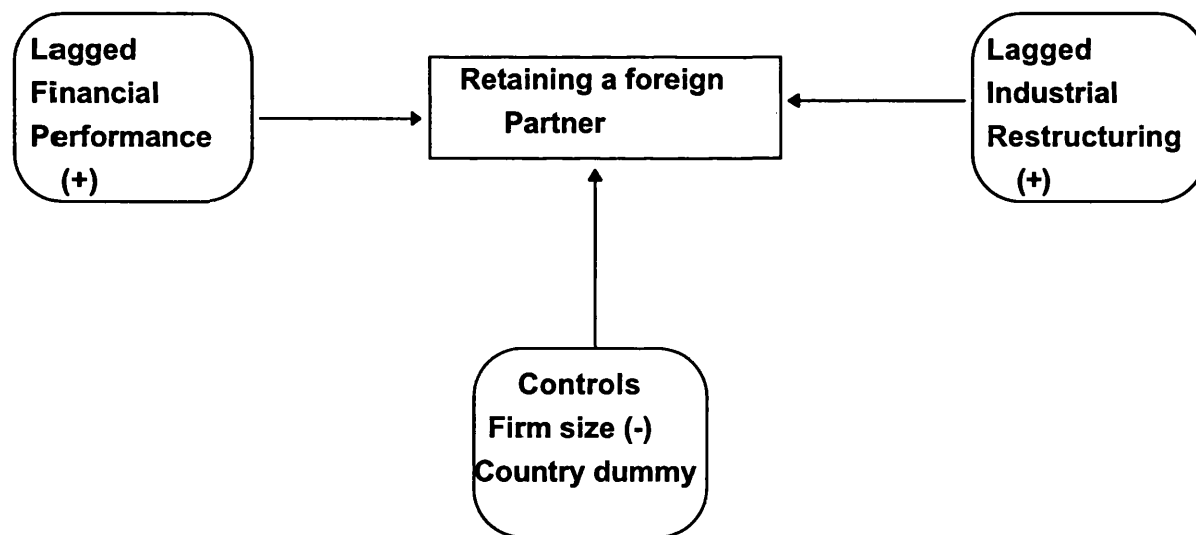
²⁷ In earlier chapters the benefits of ownership concentration were discussed, for example Shleifer and Vishny

allow owners to co-ordinate their actions more effectively, if they belong to a homogenous group. Furthermore, greater than average foreign ownership being a significant factor makes it apparent that there are complementarities between the current ownership structure and foreign partner objectives, which should boost firm performance due to reduced inter firm diversity (Adler and Greene, 1989). Lastly, country differences play a slightly significant role in determining whether a firm has gained a foreign partner or not: Russian firms are more likely to have gained a foreign partner, reinforcing results in table 7.

6.9b The factors which determine whether a firm has retained a foreign partner: an alternative approach.

Since results in table eight show that perceptions of foreign partner's objectives and resource contributions, managerial strategy, and ownership structure factors are poor predictors of whether a firm has retained a foreign partner in 1996 and 1997, an alternative model was developed, as shown below.

Diagram 2:



This provided us with the following hypotheses:

Hypothesis development

1. Controls

Beginning with firm controls, firm size is included. Results in Table six and eight showed that

firm size is negatively associated with foreign partner presence and retaining a foreign partner, reflecting that remnants of Soviet era gigantism repel foreign partners, possibly due to the huge investment required in order to upgrade product design and technology to global standards. Also larger firms may represent a greater challenge in terms of restructuring, for example there maybe a higher incidence of labour hoarding. In general terms, Stiglitz and Driffill (2000) note several problems associated with larger firms: difficulties in managing and supervising staff; greater need for bureaucracy; and slower communication. Thus we test the following:

Control 1: firm size is negatively associated with the probability of a firm retaining a foreign partner.

2. Industrial Restructuring

Industrial restructuring involves *“the whole process undertaken by enterprises as they adapt their behaviour to that necessary for survival and success in a market economy,”* Djankov and Murrell (2002).

It will be anticipated that evidence of restructuring will be positively associated with a firm retaining a foreign partner, as Smart and Waldfoegel (1994) state, *“restructuring is attributable to subsequent improvements in performance,”* (p503).

Firstly, two hypotheses will be postulated concerning *reactive* restructuring. This kind of restructuring involves labour shedding, boosting labour productivity, wage reductions and plant closures (Aghion and Carlin, in Zecchini, 1997, p244-5), reflecting that firms have moved away from the Soviet practices of labour hoarding, low fire rates and excess capacity, therefore we test the following:

H1: lagged capacity lost due to depreciation of machinery/equipment and permanent removal of workshops/plants is positively associated with the probability of a firm retaining a foreign partner.

H2: lagged labour productivity²⁸ is positively associated with the probability of a firm retaining a foreign partner.

Next three hypotheses shall be tested concerning *deep and strategic restructuring*, namely improvements in the export structure, technology changes and alterations in managerial structures (Aghion and Carlin, in Zecchini, 1997, p244-5).

²⁸ Defined as total sales/no. of employees

Job gains in production units can be expected to positively affect whether a firm retains a foreign partner or not, as they may act as a positive signal of firm growth to the foreign partner. Ijiri and Simon (1967) in their seminal text suggest that firm growth is dependent on an impetus, such as innovations in production or marketing or new managerial techniques.

In addition job gains maybe a sign of organic (internal) growth and that the firm has undergone the process of labour shedding, and now progressed to job creation within the firm. Furthermore, in the context of the FSU, Aukutsionek *et al.*, (1998) in their work on dominant shareholders and restructuring use the number of employees hired as a performance measure, therefore we test H3.

H3: gross job gains in existing and new production units (by taking the number of productive employees in 1.01.95 as 100% and giving the net change in employment in 1.01.97) is positively associated with the probability of a firm retaining a foreign partner.

By exporting to non former CMEA countries firms are illustrating that they can successfully operate on foreign markets and meet international quality standards. Brezeinski and Kaltholff (1998) treat exporting as a signal of successful restructuring in their study of Polish firms. Similarly, Landesmann (2000) states that export performance is a move towards “*active restructuring*” and represents a change in behavioural response into new markets by upgrading the composition and quality of their products. Also, Aghion and Carlin, (in Zecchini, 1997, p 278) highlight that the ability of transition economies to export to the EU, reflects their ability to penetrate high quality markets, while Jones (1998) claims that the ability of firms to find new clients is a signal of successful change.

As Bernard and Jensen (1999) state “*exporters are better than non exporters,*” (p1) as “*exporters are larger, more productive, more capital intensive and more technology intensive,*” (p2), clearly positively affecting whether a firm retains a foreign partner.

Dahlquist and Robertsson (2001) attempt to determine the determinants of foreign investment in Sweden and their results reveal that foreign investors are drawn to firms with a presence on international markets, therefore we test a similar hypothesis:

H4: export intensity is positively associated with the probability of a firm retaining a foreign partner.

A firm’s annual investment level may also affect whether a firm retains a foreign partner or not. For example, higher levels of investment may signal the ability to obtain/attract financial capital in order to undertake important and necessary investment projects. Furthermore, new investments may be a signal of *deep* restructuring. Aukutsionek *et al.*, (1998) claim that firms in Russia are operating in a

climate of industrial decline, thus we can expect firms to reduce their investment levels, thus firms who do not reduce investment, can be expected to be in a better financial position, therefore the following hypothesis is developed:

H5: lagged annual investment levels are positively associated with the probability of a firm retaining a foreign partner.

3. Financial performance

The level of lagged financial performance of the firm should also affect the probability of the firm retaining a foreign partner, this treats ownership as an endogenous factor, as opposed to hypothesising that ownership affects performance. This approach was tested by Demsetz and Villalonga (2001) who argue that “*the ownership structure of a corporation should be thought of as an endogenous outcome of decisions,*” (p210) and find that ownership structure is “*determined... by firm performance,*”(p216 and p227). Previously, Himmelberg *et al.*, (1999) had also found that ownership should be treated as an endogenous factor, and that managerial ownership is determined by changes in the firm’s contracting environment.

In a study of the determinants of foreign ownership, Dahlquist and Robertsson (2001) find that foreign investors exhibit a preference for better performing firms, with higher current ratios, reflecting the firm’s ability to meet short term payments. Similarly, Kang and Stulz (1997) find that foreign investors tend to hold shares in firms with higher levels of return on assets.

H6: lagged profit²⁹ is positively associated with the probability of a firm retaining a foreign partner.

Higher levels of liabilities may suggest that firms are able to obtain access to external finance from banks or other such sources, thus they may have no need of a foreign partner thus we test:

H7: total liabilities (to banks, suppliers, utilities, government and wage arrears) is negatively associated with the probability of a firm retaining a foreign partner.

²⁹ Of course it is accepted that another strategy would be to test the impact of profits/revenues and liabilities/revenues on foreign partner retainment, in order to control for the size effect. However, firm size in this sample is similar across years and countries (see for example table 1 in chapter four) so I hope that this would not affect results too seriously. Furthermore Filatotchev *et al.*, (2001) warn against using ratios in some scenarios.

Table 9: regression results: the alternative model

	Dependent variable: retaining a foreign partner in 1997
Capacity lost due to depreciation of machinery and permanent removal	0.38
Gross job gains in existing and new production units	0.22*
Annual investment	-0.002
Log of employees	0.4
Total liabilities	-0.002†
Labour productivity	-0.008
Export intensity	0.04†
Profit	0.0009†
Russian dummy	-12.1
Ukrainian dummy	9.71
Constant	6.05
- 2 log likelihood	39.28
Chi square	23.56**
Hosmer and Lemeshow's R ²	0.59

Notes: Sig. levels: *** p<0.001; **p<0.01; * p<0.05; † p<0. Presence of a retained foreign partner presence was coded 1, while non foreign partner presence was coded 0. Checks were made for the existence of multicollinearity problems; all VIFs were well below 10.

Beginning with firm controls, we can see that both are insignificant: firm size and country membership do not impact upon whether a firm has retained a foreign partner or not.

As for the degree of *reactive* restructuring, such as capacity depreciation and labour productivity improvements these are both insignificant factors, perhaps suggesting that foreign partners view evidence of reactive restructuring as a superficial measure of firm performance.

This is not the case for *deeper* restructuring, job gains in production units (over the period 1995-1997) and export intensity are both positively associated with retaining a foreign partner, thus we can accept H3 and H4. From this we can infer that foreign partners retain alliances with firms who have finished the procedure of labour shedding and begun to hire new workers. Furthermore they remain with local firms who have shown that they can penetrate high quality markets, by exporting to non former CMEA countries. However we cannot accept H5 as lagged investment levels do not affect whether or not a firm retains a foreign partner.

Financial performance also appears to be a significant factor of determining whether a firm retains a foreign partner. Foreign partners are clearly keen to retain strategic alliances with firms who were committed to profit maximisation and those who exhibited superior financial performance, as firm profit positively effects the probability of a firm retaining a foreign partner, allowing us to accept H6. Liabilities to banks, suppliers etc. appears to negatively affect whether a foreign partner is retained, suggesting that local firms with access to alternative sources of credit and funding do not need to continue in a relationship with a foreign partner, thus we can accept H7.

Overall, it appears that this alternative specification, using evidence of industrial restructuring and financial performance is a better model for determining whether a firm has retained a foreign partner: the R^2 has increased to 0.6 in table 9.

6.9c Implications for local firms and foreign partners.

Firstly, from the results it seems that general firm characteristics do not affect whether a firm retains a foreign partner: firms retain a foreign partner regardless of firm size or country status, which is surprising as tables 6 and 8 show firm size to be a significant determinant of foreign partner presence.

Furthermore, it appears from table nine that for a local firm to retain a strategic alliance with a foreign partner it is not enough to exhibit evidence of only reactive restructuring. Foreign partners appear only to be interested in remaining in relationships with firms which have undertaken deep restructuring. In particular, the ability to create new jobs and hire workers appeals to foreign partners, as does the ability to re-orientate the geographic structure of their exports, and to penetrate high quality, non former CMEA markets.

Moreover, if local firms wish to remain in a relationship with a foreign partner they must improve their indicators of financial performance, in terms of profits and total liabilities. In a climate of industrial decline it may be difficult for a firm to increase profits etc. and they may prefer to focus on survival, such as finding new clients/markets, developing new products, marketing strategies or production techniques. Therefore it could be claimed that measures of financial performance, such as profits are superficial and thus foreign partners should reconsider their reasons for not continuing with a strategic alliance. A firm's progress in restructuring and dealing with corporate governance issues maybe a more worthwhile consideration.

Lastly, it is clear that relationships between local firms in the FSU and foreign partners are particularly fragile. Furthermore it appears that foreign partners observe the behaviour of the local firm or find some new information about the other party, which affects whether they remain in the alliance.

An item for further research would be to examine the influence of the characteristics of the foreign partner, such as attitudes to R&D expenditure and technology transfer, on the probability of whether a firm retains a foreign partner.

Table 10

Summary tables

The following tables summarise the key findings.

Variable	Likelihood of Having A Foreign Partner	
	1996	1997
Hypothesis and anticipated sign		
C1. Employment Size (-)	Not significant	Significantly reduces likelihood of having a foreign partner
C2 Required. Investment (+)	Significantly increases likelihood of having a foreign partner	Significantly increases likelihood of having a foreign partner
H1. Perception that Foreign Partners Seek Access to Local Markets Through Local Production (+)	Not significant	N.a.
H2. Perception that Foreign Partners Seek Access to Local Technology (-)	Significantly reduces likelihood of having a foreign partner	N.a.
H3. Looking for Foreign Partner to Provide Access to Technology (-)	Not significant	Not significant
H4. Looking for Foreign Partner to Provide Access to Markets (+)	Significantly increases likelihood of having a foreign partner	Significantly increases likelihood of having a foreign partner
H5. Directors Give Priority to Domestic market strategy (-)	Significantly reduces likelihood of having a foreign partner	Not significant
H6. Export intensity (+)	Significantly increases likelihood	Significantly increases likelihood

Variable	Likelihood of Having A Foreign Partner	
	of having a foreign partner	of having a foreign partner
H7. Presence of a new Director (+)	Probability of a firm having a foreign partner increases when a firm has had a new director ³⁰ .	Not significant
H8. Greater than average employee shareholding ²⁰ (-)	Not significant	Not significant
H9. Greater than average foreign shareholding (+)	Not significant	Probability of a firm having a foreign partner falls when a firm does not have greater than average foreign shareholding
Country dummy 1. Russia	Significantly increases likelihood of having a foreign partner	Not significant
Country dummy 2. Ukraine	Not significant	Not significant

Hypothesis and anticipated sign	Retaining a foreign partner	Gaining a foreign partner
C1. Employment Size (-)	Significantly reduces likelihood of retaining a foreign partner	Not significant
C2 (Required) Investment (+) For <i>gained</i> a foreign partner independent variable is "required investment. For <i>retained a foreign partner</i> independent variable is annual investment	Significantly increases likelihood of retaining a foreign partner	Not significant
H1. Perception that Foreign Partners Seek Access to Local Markets Through Local Production (+)	Not significant	Significantly increases likelihood of retaining a foreign partner
H2. Perception that Foreign Partners Seek Access to Local Technology (-)	Not significant	Not significant
H3. Looking for Foreign Partner to Provide Access to	Not significant	Not significant

³⁰ Support for H7 was also found in the pooled specification. H8 was rejected in the pooled specification.

Hypothesis and anticipated sign	Retaining a foreign partner	Gaining a foreign partner
Technology (-)		
H4. Looking for Foreign Partner to Provide Access to Markets (+)	Not significant	Significantly increases likelihood of retaining a foreign partner
H5. Directors Give Priority to Domestic market strategy (-)	Significantly reduces likelihood of retaining a foreign partner	Significantly increases likelihood of retaining a foreign partner
H6. Export intensity (+)	Not significant	Not significant
H7. Presence of a new Director (+)	Not significant	Significantly increases likelihood of retaining a foreign partner
H8. Greater than average employee shareholding ²⁰ (-)	Not significant	Significantly increases likelihood of retaining a foreign partner
H9. Greater than average foreign shareholding (+)	Not significant	Significantly increases likelihood of retaining a foreign partner
Country dummy 1. Russia	Not significant	Significantly increases likelihood of retaining a foreign partner
Country dummy 2. Ukraine	Not significant	Not significant

Hypothesis and anticipated sign	Retaining a foreign partner: an alternative model
Control 1: firm size (-)	Not significant
Control 2: Country membership ³¹	Not significant
H1: capacity depreciation (+)	Not significant
H2: labour productivity (+)	Not significant
H3: job gains (+)	Significantly increases likelihood of retaining a foreign partner
H4: export intensity (+)	Significantly increases likelihood of retaining a foreign partner
H5: annual investment level (+)	Not significant
H6: profit (+)	Significantly increases likelihood of retaining a foreign partner
H7: total liabilities (-)	Significantly decreases likelihood of retaining a foreign partner

³¹ No hypothesis is made concerning country status.

CHAPTER SEVEN: CONCLUSIONS, CONTRIBUTIONS, IMPLICATIONS AND FURTHER RESEARCH

This first part of this chapter shall present a summary of the main findings of my thesis and make comparisons with existing research. The second section shall deal with my contributions to the internationalisation literature and the third shall examine some of the implications of my findings, along with presenting some tentative policy conclusions. Lastly, several points for further research shall be discussed.

1. Principal Findings in Chapter five.

Here the key findings shall be summarised and tabulated in order to see how they compare with existing internationalisation research. Also we will see if the key results are transition specific¹ (the relationship is unique to the CIS) or theory specific (a similar relationship has been found in existing research).

Beginning with the main findings for the determinants of exporting we have the following table:

Table 1: Determinants of exporting

Independent variable	Relationship with exporting activity
Firm size	Positive
Industrial decline- (industry's reported decline in real output over 1993-1996 as a % of 1993 level.)	Positive
Foreign ownership	Positive
Institutional ownership	Positive
Dominant group of owners	Positive
% of seats held by outsiders	Negative
% of seats held by outsiders* % of shares held by outsiders	Positive

Firstly, dealing with firm size, a key variable in export research, this appeared to be strongly and positively associated with exporting. This supports existing research by Perkett (1963) and Delgado *et al.*, (2001), who both also found positive relationships between exporting and firm size in the UK and Spain, respectively. Thus it appears that the relationship between firm size and exporting is not transition specific, and secondly that the international business framework can be applied to the economies of the CIS. However this disagrees

with the findings of Bonaccorsi (1992) who found that small firms are more likely to be exporters in Italy.

Bonaccorsi also highlights the importance of the causality issue: does exporting affect firms size? This would be a useful extension for further research; could firms in the CIS use exporting as a means for growth²?

Next we can see that industrial decline positively affects export activity, this proves that the context of the CIS is not unique in terms of industrial decline leading to exporting.

Furthermore we can successfully employ the strategy based framework, as it is clear that exporting is used as a strategy to overcome difficult market conditions. For example, other researchers working under the strategy doctrine, such as Barker and Duhaime (1997) find that if a firm is in decline (i.e. its performance is below the industry average) then it will be forced to implement strategic change. It could be argued that this will affect exporting activity, as exporting is treated here as a strategy to improve performance (see chapter five, section 5.1 for a rationale of this framework). In addition, Pavord and Bogart (1975) found that poor market conditions lead firms to seek export markets as a strategy for survival, which is similar to my result.

The analysis showed that foreign ownership appeared to have a positive influence on exporting, supporting the work of many other researchers in the sphere of the economics and transition literature. The seminal text by Caves (1996) states that foreign owners are either motivated by the desire to market seek (and serve the domestic market) or export extensively (foreign sourcing). Clearly in the case of the CIS foreign owners are foreign sourcing, and using the host firm as an export platform. In the case of Spain, Molero (2001) found that a common strategy of foreign owners is to use the host country as an export platform. This phenomenon is not rare in transition economies. Rojec *et al.*, (2000) find that Slovenian foreign owned firms are more likely to export a larger proportion of their output than majority domestically owned firms and MacBean (2000) finds that the output of foreign owned Czech firms is export orientated. Thus it appears that the relationship between foreign ownership and exporting in the CIS is not transition specific.

¹ Of course it is accepted that there are differences between groups of transition economies such as the CIS countries and those of Central and Eastern Europe, see for example, The Transition report, 1998.

² Assuming that the firm has already downsized, and that any employment growth would not led to inefficiencies.

Johnson *et al.*, (1996) document the recent dramatic increase in institutional ownership and state how it has become an important monitoring body. Results from my research show that institutional owners try to implement performance improving policies and thus positively influence exporting. This reflects that agency theory can be applied to the CIS environment, as institutional investors are willing to undertake the associated agency costs³, and therefore are able to successfully monitor management.

Other researchers have also highlighted the positive role of institutional investors, for example Kochar and David (1996) find that institutional investors are “active” and exercise their voice to attempt to influence management decisions. Wahal and McConnell (2000) find that this type of owner possesses an informational advantage and also allows management to focus on projects with long term payoffs. In a transition context Perotti and Gelfer (2001) find that financial industrial groups (FIGs) play an important governance function and successfully monitor management activity. Coupled with my findings, this may tentatively suggest that FIGs and institutional owners are not such a nefarious governance body, as thought previously.

However this ignores the existence of selection bias among institutional owners, who may select firms with superior performance, thus the relationship may run the opposite way: with exporting leading to the incidence of institutional ownership.

A unique element of my thesis was to look at the impact of a *group* of dominant owners on exporting activity, which was found to have a positive influence.

Earlier, La Porta *et al.*, (1999) found that widely held ownership is not common in economies with poor shareholder protection in a survey of 27 wealthy economies, and more recently Dyck (2001) highlighted that multiple blockholders can be efficient in an environment where legal protection is poor. This is a result common with my research as groups of shareholders coalesce as their rights are not well protected, in order to monitor managerial strategy towards exporting. Therefore, it appears that the La Porta *et al.*, framework is useful for understanding the determinants of exporting in the CIS.

A principal result is that groups of owners behave similarly to a single owner and strive to improve firm performance. Also, this is not a transition specific finding, as other researchers have also documented a positive relationship between concentrated ownership and

³ See Jensen and Meckling (1976) for a description.

performance in developed countries. For instance, Shleifer and Vishny (1986) found that large shareholders boost expected profits, while Bethel and Liebskind (1993) state that blockholders can exert a disciplinary effect upon management.

However, the literature has also documented negative effects of blockholders. Black (1999) has found that large shareholders are prone to insider dealing and asset stripping within a transition context. Thus, although groups of shareholders positively affect exports it remains to see if they are solely a positive influence for other aspects of the performance of firms.

Next it was found that board representation of outsiders is negatively (albeit weakly) associated with exporting activity. This appears to be a transition specific result, as previous research has supported the resource dependence role of outsider board members, as postulated by Pfeffer and Salancik (1978). They state that outsider board members can bring resources and knowledge to the firm. However, this appears not to be the case in the CIS, as outsiders are found not to be adopting exporting as a strategy to improve performance. One very tentative reason for this could possibly be a lack of specialised knowledge concerning exporting or other board members forcing them to collude with their decisions and strategies.

However, outsider control (defined by the interaction of the percentage of seats held by outsiders and the percentage of voting shares held by outsiders) provided a stronger result and was found to positively affect exporting activity. This reflects that board representation and share ownership are complementary in affecting exporting. This suggests that in the context of the CIS outsider owners require board representation in order to influence strategy in order to improve firm performance. See Filatotchev *et al.*, (2001b) who first developed the link between complementarity of corporate governance factors.

Thus it seems clear that there is a strong relationship between ownership and exporting activity, an issue widely ignored in the internationalisation literature, as Dosaglu-Guner (2001) points out, this research topic “*has not been developed, despite a possible link,*” (p72). Thus I hope to have contributed to and expanded this literature.

Lastly, by running separate equations for each year it was found that the exporting process is temporal. This is similar to findings by Bilkey (1976): the factors which affect the decision to

export change over time. In addition, Johanson and Vahlne (1977) in their seminal work state that internationalisation is an incremental, sequential process.

1.b Principal Findings in Chapter six.

Firstly, the determinants of foreign partner presence were examined. The key results are shown below.

Table 2: Determinants of foreign partner presence.

Independent variable	Relationship with foreign partner presence
Firm size	Negative
Required investment	Positive
Foreign partner seeks access to local technology	Negative
Host seeks access to markets	Positive
Managers give priority to domestic market strategy	Negative
Export intensity	Positive
Presence of new director	Positive
Presence of greater than average foreign ownership	Positive

The results in this section are transition environment specific as the majority of extant research has focused on characteristics of the partner from the developed country.

Firstly, firm size reduces the likelihood of foreign partner presence. This possibly reflects the problems associated with large firms, such as slow communication and supervising staff (Stiglitz and Driffill, 2000).

Next it was found that required investment increases the likelihood of a firm having a foreign partner, thus foreign partners are being attracted to alliances where their resources are needed the most (as in Wright *et al.*, (2002)).

A unique contribution of this research is to incorporate the perceived resource contributions of the CIS firm's partner and perceptions of local firm attractiveness.

Local firms perceiving foreign partners to bring access to markets increases the firm's likelihood of having a foreign partner. This reflects that the host and foreign partner have similar objectives concerning access to markets.

As for managers giving priority to strategy geared toward the domestic market this reduces the probability of a firm having foreign partner. Strategy geared towards domestic market strategy could reflect that management is risk averse (Hitt *et al.*, 1997), which may repel potential foreign partners, as they perceive managers not to be interested in the risky process of internationalisation.

It was found that foreign partners perceiving local firms as attractive for access to local technology reduces the probability of foreign partner presence. This suggests that technology transfer is a difficult issue⁴. This is clearly not limited to the transition environment, for example Fey (1995, p141) documents the issue of conflict in the literature, so once again the international business framework can be applied

The level of export intensity was found to increase the probability of a firm having a foreign partner. Foreign partners may view a local firm's ability to export as a signal of active restructuring (Landesmann, 2000) and having broken away from central trade monopolies. In addition, we may be able to tentatively conclude that foreign partners view exporting as a positive performance measure, an assumption similar to that in chapter five, which stated that exporting is a strategy to improve firm performance. Also, exporting activity can be used as a performance measure in itself, particularly in less developed or transition economies, for example Douglas (1996) uses export sales volume as a performance measure in her study of Peruvian firms.

Previous research has documented the positive influence of managerial turnover, for example Warzynski (2001) has found that managerial turnover boosts productivity in Ukraine. In addition, Ocasio (1993) found that a change in top management leads to a change in organisational strategy. It is likely that increases in productivity and new strategy (assuming it is moving away from that of the Soviet era) will appeal to potential foreign partners.

Similarly, the presence of greater than average foreign ownership increases the likelihood of having a foreign partner. This suggests that foreign partners are seeking a homogeneous ownership structure, in anticipation of sharing similar objectives. More generally, foreign partners could be attracted to outside ownership per se, as several researchers in transition economies have found outsider and foreign owners to be beneficial for restructuring (see

⁴ Also managers may not even desire monetary compensation for technological transfer, full control may be the crux of the matter.

Djankov and Murrell (2002)). While Konings (1999) found that foreign owners have greater access to technological know how and finance, which could clearly be an attractive attribute for a potential foreign partner.

Lastly, it was found that the foreign partner selection process is time variant, as the motives and determinants of foreign partner presence change over the two year period. Hitt *et al.*, (2001) had previously recommended that the process should account for the time factor.

Following this, logistic regression was undertaken to determine the factors which affect whether a firm gains a foreign partner. The key results are shown in table three.

By referring to tables 2 and 3 it is clear that many of the factors which determine the likelihood of foreign partner presence are similar to those which determine whether a firm gains a foreign partner in the two year period. Therefore only those factors which do not appear in table 2 shall be discussed.

Firstly, *both* the local and foreign partner seeking access to markets positively affects the likelihood of a firm gaining a foreign partner. This reflects that both parties are interested in exporting, possibly in order to boost firm performance, as suggested in chapter five. Thus it appears that for a firm to gain a foreign partner both parties must “match” their objectives and strategies.

Another interesting result is that both greater than average foreign *and* insider ownership increases the likelihood of gaining a foreign partner. This suggests that potential partners seek firms with homogenous ownership structures, as opposed to diffused ownership structure, in anticipation of incentive alignment and easier co-ordination of activities. This may reflect that potential partners find it easier to negotiate contracts when there is a high level of homogeneity between owners.

Table 3: Determinants of gaining a foreign partner.

Independent variable	Relationship with gaining a foreign partner
Firm size	Negative
Required investment	Positive
Foreign partner seeks access to local market	Positive
Host seeks access to markets	Positive
Managers give priority to domestic market strategy	Negative

Independent variable	Relationship with gaining a foreign partner
Export intensity	Positive
Presence of new director	Positive
Presence of greater than average insider ownership	Positive
Presence of greater than average foreign ownership	Positive

Lastly, an alternative model was developed in order to determine the factors which affect the probability of a firm *retaining a foreign partner* over the two year period. The key results are shown below.

Table 4: Alternative model

Independent variable	Relationship with retaining a foreign partner
Job gains (taking 1.1.95 as 100%, this represents the net change in employment on 1.1.97)	Positive
Export intensity	Positive
Profit	Positive
Total liabilities (the sum of liabilities to banks, suppliers, utilities, government and wages)	Negative

Firstly, it should be noted that general firm characteristics and evidence of reactive restructuring⁵ (in particular labour productivity and capacity depreciation) do not impact upon whether a firm retains a foreign partner. However, evidence of so called deep restructuring (namely export intensity and gains in net employment) along with financial performance are both important determinants. Hypotheses were made concerning the relationship between restructuring and the presence of a retained foreign partner as it was anticipated that they would wish to remain in an alliance with a firm which had shown evidence of improving export structures and increasing productivity etc. These hypotheses treat ownership as an endogenous factor, similarly to Demsetz and Villalonga (2001). Beginning with deep restructuring, the likelihood of a firm retaining a foreign partner increases if firms have experienced job gains in existing or new production units over the period 1995-1997.

⁵ See section 6.9b in chapter six for a discussion on restructuring.

Another aspect of deep restructuring which is an important determinant of retaining a foreign partner is the level of export intensity. Clearly, a foreign partner is more likely to be retained in those firms where it is obvious that they can meet international quality standards, which is essential if firms are to export successfully to non CMEA countries.

In addition, financial performance plays a significant role in determining whether a firm retains a foreign partner. It appears that profit is a positive influence. This appears not to be a CIS specific finding, as Demsetz and Villalonga (2001) and Bishop *et al.*, (2001) (in the case of Hungary) both treat the ownership structure of firms as an endogenous factor and find that it is likely to be affected by firm performance.

Conversely, the level of total liabilities reduces the likelihood of a firm retaining a foreign partner. Liabilities may reflect the ability of the firm to gain access to credits from banks, suppliers, utility companies and the State, this finding may suggest that foreign partners remain in alliances with firms which require their resources the most, which suffer from poor levels of access to credit, and thus low levels of liabilities. Similar results were found in the tables above, as required investment positively influences the likelihood of foreign partner presence.

2. Research Contribution

I believe that I have made several contributions to the research on the internationalisation process in the methodological, empirical and theoretical fields.

I also hope to have contributed to the strategy, international business and economics literatures.

1. Empirical techniques contribution

Firstly, I have used a wide variety of empirical techniques to test hypotheses, whereas previous researchers have used only employed a single technique, for example Bhavani and Tendulkhar (2001) and Dosoglu-Guner (2001) have only used logistic regression in their studies of exporting firms. Furthermore I have had access to a database from a research team at the University of Nottingham which was collected from a unique survey within a particular institutional setting, enhancing the importance of the results.

2. Methodological contribution

I have extended the research on the relationship between ownership and exporting. Other researchers have only used a maximum of three dummy variables to represent ownership, for example Javalgi *et al.*, (1999) use a dummy variable in order to distinguish between publicly and privately held firms. Bhavani and Tendulkhar (2001) use a dummy variable to represent if a firm is a single proprietorship or a limited company, while Dosaglu-Guner (2001) employs dummy variables to determine whether a firm is pure proprietorship, insider or externally owned. In comparison my research has employed a wide variety of ownership and board structure variables.

In addition, I have assumed that the factors which affect exporting change over time, as recommended by Bilkey (1976), therefore I have used lagged independent variables over a two year time period, as well as having employed techniques for pooled regression, along with repeated measures techniques. Some researchers were unable to introduce a temporal element in the exporting process, such as Bhavani and Tendulkhar (2001), who have used cross sectional data only.

3. Theoretical contribution

Another innovation is to employ both *internal and external* factors in determining export activity, such as firm characteristics along with exogenous factors such as industrial decline. This relies on the existing work of the research team at the University of Nottingham, such as Buck *et al.*, (2000), Filatotchev *et al.*, (2001b) and Filatotchev *et al.* (1999), Wright *et al.*, (2002, 2000), and Zhukov (1999).

Other researchers have limited their research to one kind of factor, Javalgi *et al.*, (1999) for example, only concentrate on internal factors.

Integration into the world economy is a vital part of economic transformation for the transition economies (Transition Report, 2001). Hopefully, by examining the impact of firm characteristics on exporting we can develop a profile of exporting firms in transition economies, which can help to assist non exporting firms to begin to enter global markets, and thus form an export promotion policy. This should be beneficial as Bilkey (1976) emphasises the importance of export profiles in identifying potential exporters among firms which are not already exporting. For example, export profiles created by Cavusgil (1976)

can be used by government export agencies to identify those firms with a high export potential, thus limited resources for export promotion (loans, export training) can be concentrated on the high export potential firms.

Foreign partner selection research contributions

I hope to have made several research contributions to the area of foreign partner selection process also.

1. Methodological contribution

Furthermore I have assumed that foreign partner selection is a temporal process, and have therefore studied the determinants of a firm *gaining* and *retaining* a foreign partner.

In particular, I have developed a model of retained foreign partner presence by examining the influence of reactive and deep restructuring and financial performance. As far as I am aware, I do not know of any of other research which has covered such a topic.

2.Theoretical contribution

Firstly, most foreign partner research has concentrated upon the motives and characteristics of the foreign partner, as opposed to the host firm, moreover very few researchers have examined partner selection in the environment of the transition economies⁶.

Another novel aspect of my research is to examine the impact of foreign partner and local firms' perceptions of resource contributions and objectives for a strategic alliance. Other researchers, such as Fey and Beamish (2000) have examined the impact of organisational climate, culture and parent firm commitments on joint venture conflict, while Brouthers and Bamossy (2000) have examined the influence of governments on joint venture negotiations. They found that transitional governments acting as key stakeholders intervene at different stages of the negotiation process, however they can change the balance of power, occasionally to the detriment to their own state owned enterprise.

The majority of my findings have not been transition specific, and some of my results are similar to those found by researchers on developed market economies, such as that involving the relationship between firm size, industrial decline, foreign ownership etc., and exporting.

⁶ Of course one exception is the work of Hitt *et al.*, (2001) who examine foreign partner selection in Poland and Romania.

Also the results on foreign partner presence confirmed that ownership structure should be treated as an endogenous factor, and is determined by firm performance, as first documented by Demsetz and Villalonga (2001) in the case of firms in the US.

The exception is the result concerning the representation of outsiders on boards, which was found to negatively (albeit weakly) effect exports. This refuted the resource dependence role (Pfeffer and Salancik, 1978) often found in studies of board structure and performance carried out in Western economies. Therefore we can conclude that this is a transition specific finding. However the interaction of outsider ownership and board membership appeared to be the stronger result, with a higher significance level, reflecting that both aspects are needed in order to influence exporting activity.

The result concerning the impact of a dominant group of owners on exporting also relates to other middle income economies with poor legal environments, as it was found that groups coalesce to improve performance in the CIS countries. Thus it could be claimed that this finding is transition or middle income country specific.

Several frameworks or theoretical perspectives were implemented in order to carry out the research, namely international business, economics, and strategic management based literature. For the research on exporting behaviour it appears that the international business and economics frameworks were the most useful, whereas for research on foreign partner presence all three frameworks could be implemented successfully. Overall, it appears that the three perspectives are complementary in determining the internationalisation process.

3. Implications

Next the implications of these findings will be discussed.

It is clear that certain ownership structures should be encouraged if firms are to export. Foreign owners, as well as institutional owners have proved to be active monitors of management, and have attempted to implement performance improving strategies, such as exporting. This refutes the negative effects of foreign and institutional owners reported by Thirlwall (2000) and Bim (1995) respectively.

Instead, these types of owners should be encouraged by government policy, by introducing tax breaks and other incentives; for example Lankes and Venables (in Zecchini, 1997)

document the importance of tax breaks, removing barriers to trade and creating an environment of political stability in order to attract foreign investors to transition economies. Surprisingly, the level of outsider ownership has an insignificant impact upon exporting. However when outsider ownership is coupled with board representation it has a significant positive influence. Therefore the discrepancy between outsider ownership and board representation, mentioned by Blasi *et al.*, (1997) should be dealt with, in order for outsider owners to play a greater part in decision making and strategy implementation, see also Filatotchev *et al.*, (2001b).

Furthermore it was found that a group of dominant owners positively affect exporting activity. Although it appears that these groups of similar owners are co-ordinating activities in order to improve performance by exporting, it is not clear whether they are implementing other strategies which may impede firm performance. Many researchers of concentrated ownership in transition economies have found some worrying results. As early as 1995 Gurkov and Asselbergs had reported negative findings about outsider blockholders who do not focus on improving the long term performance of the firm. Black (1999) found that controlling shareholders were taking part in asset stripping and insider dealing, while more recently Filatotchev *et al.*, (2001) found that large blockholders are negatively correlated with investment and firm performance in Russian firms. Given these serious misgivings, legal mechanisms will need to be put in place to prevent such occurrences⁷.

Several implications are also borne from the research on foreign partner presence. Results have shown that the perception that foreign partners are seeking access to local technology, and managers giving priority to domestic market strategy reduces the likelihood of foreign partner presence. Clearly policy needs to focus on reducing the problems associated with technology transfer, as well as adapting managerial attitudes towards foreign market development, by creating a secure framework of property rights and introducing internationalisation education programmes for managers⁸.

Secondly, it was found that the level of export intensity increases the likelihood of foreign partner presence. Thus if policy makers wish to attract more potential partners then one

⁷ Since the relationship between board structure and exporting was weak no policy implications shall be given.

⁸ Of course these policies maybe ineffective if managers are only interested in full control of the company.

such route would be to make the export process easier for firms, this could be done by removing the need for export licenses and providing loans for firms wishing to export.

Another interesting result was that managerial turnover is positively linked to foreign partner presence, thus if firms wish to attract a foreign partner they need to show that the former Red Directors have been removed. This could be a very difficult process for firms, so perhaps funds need to be created in order to compensate leaving directors, or for re-training them, as well as giving assistance in recruiting new managers.

Lastly, it is apparent that foreign partners are attracted to homogenous ownership structures, so firms should try to emanate these structures if they wish to ease the co-ordination of activities and be able to attract a foreign partner.

Perhaps more importantly firms need to *retain* a foreign partner. In order to do this they must provide evidence of deep restructuring, in particular they must have experienced job gains in production units and have begun to export to non former CMEA countries.

Therefore policy should focus once again on encouraging exports by focusing upon active labour market policies. For example, Coe and Snower (1997) suggest using a well balanced selection of policies to assist exchange of information on job vacancies, assist training and job creation via employment subsidies.

Perhaps one of the key findings of this research is that alliances between foreign partners and CIS firms are extremely fragile. The inauguration of a national foreign direct investment agency, similar to that which exists in Poland⁹, could be useful. This could act as an information agency for potential partners and help both parties match their strategic objectives

⁹ This is more commonly known as PAIZ: Polish Agency for FDI.

4. Points for further research.

Whilst carrying out my PhD I found several other interesting aspects of the internationalisation process I would like to explore further.

Firstly, it would be interesting to examine whether firms with high export intensities also have high levels of import intensities, in order to determine whether those firms which produce for foreign markets need to import their inputs for production.

Preliminary analysis has shown that there is a positive correlation at 5% level between export intensity and import intensity. An important policy implication stemming from this line of research could show that firms' exports and thus performance may be hindered by insufficient access to imports, which could reflect a need to reduce tariffs.

Cavusgil (1984) noted that it is now the general opinion of governments, agencies and financial leaders that the best method to remedy a trade deficit is to boost exports, as opposed to restricting imports. Similarly, Javalgi *et al.*, (1999) documented that the US government renewed efforts to expand manufacturing exports in order to address the trade deficit. An interesting point for further research would be to examine the impact of exports on the trade balances in Russia, Ukraine and Belarus.

Bernard and Jensen (1999) examine the complex relationship between firm performance and exporting, and find that employment growth and probability of survival are higher for exporting firms. I would like to pursue this topic and see how exporting affects other performance measures in the Nottingham dataset.

Lastly, I would like to examine the determinants of other modes of internationalisation, such as licensing and outward foreign direct investment, in a similar vein to that of Bulatov (1998) who examines the motivations of Russian firms investing abroad.

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APPENDIX**A GENERAL COMPANY DETAILS**

Name of company, legal status

Address, telephone number

Person interviewed, position

Number of employees

Date of interview

Personal discussions to resolve the issue	Yes	No
Decision by the bank to keep the situation under review	Yes	No
Rescheduling of loan payments	Yes	No
Legal action	Yes	No
Refusal to give a new loan	Yes	No
None, the bank has ignored it	Yes	No

7. Taking the capacity level in 1.01.1997 as 100% what percentage of capacity has been lost in 1.01.1998 due to:

- depreciation of the machinery and equipment
- the permanent removal (sale, leasing out, etc.) of a workshop or whole plant

8. *Since 1.01.1997* has the company established or acquired a capital stake in the following (please, indicate approximate size of the stake):

- | | Minority
stake | Controlling
stake |
|--|-------------------|----------------------|
| - another industrial company | | |
| - bank or other financial organisation | 0 | |
| - trade company | | |
| - joint venture with foreign partner | | |
| - consultancy or services firm | | |
| - a firm abroad | | |

C MARKET STRUCTURE

9. Please, give an approximate breakdown of your markets (percentage of sales)

	January 1998
Russian market	
Export to CIS	
Export to former CMEA	
Export to outside former CMEA	

10. What percentage of your inputs are purchased from (percentage of purchases):

	January 1998
Russia	
Import from CIS	
Import from former CMEA	
Import from outside former CMEA	

11. Do you consider that your main products do not sell better on world markets as a result of (score your answers as follows: 1 = little importance, 7 = very important):

- high price	1	2	3	4	5	6	7
- weak advertising	1	2	3	4	5	6	7
- poor quality	1	2	3	4	5	6	7
- slow delivery	1	2	3	4	5	6	7
- adverse terms of payments	1	2	3	4	5	6	7
- poor after-sale servicing	1	2	3	4	5	6	7
- poor managerial connections and networks	1	2	3	4	5	6	7

12. Would the achievement of world product standards require: (score each factor as follows: 1 = low importance, 7 = high importance):

- investment in machinery and equipment	1	2	3	4	5	6	7
---	---	---	---	---	---	---	---

- investment in research and development	1	2	3	4	5	6	7
--	---	---	---	---	---	---	---

- acquisition of patents, licenses	1	2	3	4	5	6	7
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- investment in marketing	1	2	3	4	5	6	7
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13. Estimate the level of product market competition faced by your company (score each factor as follows: 1 = low importance, 7 = high importance):

Upon privatisation	1	2	3	4	5	6	7
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In 1996	1	2	3	4	5	6	7
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Now	1	2	3	4	5	6	7
-----	---	---	---	---	---	---	---

14. If product market competition has increased, how important were the following sources of competitive pressure (score each factor as follows: 1 = low importance, 7 = high importance):

Import from the West	1	2	3	4	5	6	7
----------------------	---	---	---	---	---	---	---

Competition from other national or CIS producers	1	2	3	4	5	6	7
--	---	---	---	---	---	---	---

15. Please, indicate the importance of personal networks and connections between managers of your company and the following (score each factor as follows: 1 = low importance, 7 = high importance):

Managers at buyer firms	1	2	3	4	5	6	7
-------------------------	---	---	---	---	---	---	---

Managers at supplier firms	1	2	3	4	5	6	7
----------------------------	---	---	---	---	---	---	---

Managers at competitor firms	1	2	3	4	5	6	7
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Political leaders at the various levels of the government	1	2	3	4	5	6	7
---	---	---	---	---	---	---	---

Official and regulatory organisations (Tax authorities, etc.)	1	2	3	4	5	6	7
---	---	---	---	---	---	---	---

16. What are the likely most important sources of your investment finance (score each factor as follows: 1 = low importance, 7 = high importance):

Selling/leasing your buildings and equipment	1	2	3	4	5	6	7
--	---	---	---	---	---	---	---

Retained earnings (profits)	1	2	3	4	5	6	7
Credits from Russian Banks	1	2	3	4	5	6	7
Credits from Foreign Banks	1	2	3	4	5	6	7
Credits from industrial partners	1	2	3	4	5	6	7
State financial support	1	2	3	4	5	6	7
Issue of equity to Russian investors	1	2	3	4	5	6	7
Issue of equity to Foreign investors	1	2	3	4	5	6	7
Issue of bonds	1	2	3	4	5	6	7

17. Do you have a foreign partner/investor? Yes No

Are you actively looking a foreign partner/investor? Yes No

If YES to any of these questions, please, specify why (score each factor as follows: 1 = not important, 7 = of great importance):

Introduction of new technology for existing products	1	2	3	4	5	6	7
Introduction of new technology for new products	1	2	3	4	5	6	7
Rehabilitation of existing machinery	1	2	3	4	5	6	7
Training managers in marketing, finance, quality management etc.	1	2	3	4	5	6	7
Access to foreign markets	1	2	3	4	5	6	7
General advice and consultancy	1	2	3	4	5	6	7

D DIRECTORS AND WORKERS

19. What priority does the Directorate now give to the following functions (score each function as follows: 1 = low priority, 7 = high priority):

Development of new products/ services for export	1	2	3	4	5	6	7
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Development of new products/ services for domestic market	1	2	3	4	5	6	7
Marketing and advertising	1	2	3	4	5	6	7
Seeking new domestic markets for existing products	1	2	3	4	5	6	7
Seeking new export markets for existing products	1	2	3	4	5	6	7
Increasing sales of existing products by reducing price	1	2	3	4	5	6	7
Reducing labour force	1	2	3	4	5	6	7
Reducing non-labour costs	1	2	3	4	5	6	7
Monitoring of cash flow	1	2	3	4	5	6	7
Monitoring firm's return on investment	1	2	3	4	5	6	7
Short-term profit targets set by the Directorate for managers of different parts of the company	1	2	3	4	5	6	7
Seeking investors	1	2	3	4	5	6	7

20. Since 1.01.1997 what changes have there been to the Directorate?

- New General Director	Yes	No
- Replacement of other member of the Directorate	Yes	No
- Has General Director quit voluntarily?	Yes	No

22. Are Directors planning to purchase shares from employees?

Yes No

23. Please indicate the percentage of *VOTING SHARES* held by each of the following
(*TOTAL = 100%*):

January 1998

Individual Directors in Total

Individual Workers in Total

All Employees Collectively

Trading Partners

Investment Funds

Banks

External Private Individuals

The State

Holding Companies

Foreign Investors

Other Organisations (please, specify)

TOTAL

100

E OUTSIDE SHAREHOLDERS

26. How many seats on the Supervisory Board are held by representatives of the following:

	Number of seats, 1.01.1998
Banks	
Investment Funds	
Private Individuals outside the company	
Industrial Organisations	
Foreign Company	
Managers	
Employees	
State Property Fund	
TOTAL	

27. Is your company generally attractive to a foreign investor? Yes No

If NO, please, explain, why (score each factor as follows: 1 = not important, 7 = of great importance):

- majority stake is owned by employee-shareholders	1	2	3	4	5	6	7
- the size of necessary investment	1	2	3	4	5	6	7
- instability of consumers' demand	1	2	3	4	5	6	7
- there are more attractive companies in the same industry	1	2	3	4	5	6	7
- management is hostile to outsiders	1	2	3	4	5	6	7
- lack of understanding of company's potential	1	2	3	4	5	6	7
- shortcomings in skill base	1	2	3	4	5	6	7
- ecological problems	1	2	3	4	5	6	7